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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner

vs.

C. GORDON ANDERSON, TRUSTEE

Respondent

Petition For Writ of Certiorari To the United States Court of Appeals For the Fifth Circuit

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Respondent

Petition For Writ of Certiorari To the United States Court of Appeals For the Fifth Circuit

The petitioner, the Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc., respectfully prays that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit, entered in the captioned case August 12, 1966.

OPINIONS BELOW

The Fifth Circuit opinion below, 364 F2d 936, and its closely related earlier opinion, 334 F2d 118, are printed App. 6a, 3a[1]. Citations of several other Fifth Circuit opinions at earlier stages of the case are collected, App. 6a n.1. Unreported opinions of the District Court in the current case (III 260,387,389) appear at App. 14a-32a.

JURISDICTION

The judgment of the Fifth Circuit is dated and was entered August 12, 1966 (III 563). By order dated November 8, 1966, Mr. Justice Black extended the time for filing a petition for writ of certiorari to January 9, 1967. This Court's jurisdiction is invoked under 28 USC §1254 (1) and 11 USC §47c (Bankruptcy Act, §24c).

QUESTIONS PRESENTED

1. Whether a Chapter X plan of reorganization may be sustained without hearing on substantial issues going to the essential fairness of the plan, where the District Court has denied hearing on the ground that those issues had been foreclosed by an earlier decision of the Court of Appeals, and the Court of Appeals thereafter rules that the issues had not been foreclosed, but leaves untouched the lower court decision.

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[1]Citation conventions: "App.", the appendix to this petition; "III", the record, 5th Cir. #22,652, directly underlying its proceedings on the 1965 plan of reorganization herein involved; "I", the printed record of appeals on a 1959 plan, 5th Cir. #18,475; "II", the record of appeals on a 1962 plan, 5th Cir. #19,996. By stipulation (III 403), I and II were incorporated by reference in III, and have been lodged in this Court under supplemental certificate.

2. Whether a plan of reorganization may be sustained without investigation on-the-record of alleged improper affiliations of the trustee.

3. Whether a plan of reorganization may be sustained where responsible charges of serious fraud against major creditors have been refused on-the-record investigation, and whether compromises of major claims against the debtor and of the debtor's claims, setoffs and counterclaims against these creditors may be compromised without record disclosure of the issues, the facts, the disposition to be made and the reasons for the disposition.

4. Whether a plan of reorganization may be sustained when valuation has been determined on past history alone in explicit rejection of controlling requirements that valuation be based on capitalization of projected earnings, and where proffered evidence of business facts and reorganization facts tending to show the immediately postreorganization earning power of the enterprise has been rejected.

5. Whether stockholders may be entitled to creditor treatment in reorganization where they have bought their stock in a market fraudulently manipulated by the debtor in conspiracy with major creditors, and whether stockholders' claim of creditor treatment may be rejected without hearing on the ground of laches, although the contention was timely known to all parties and was timely acknowledged by the trustee to be valid and meritorious.

In addition, if certiorari is granted, there will be presented for review the following issue decided below

on appeal from a preceding plan — where, however, it was not a final determination but remained ambulatory until embodied in the current plan.

7. Whether a reorganization trustee is prophylactically barred from becoming president of the company.

STATUTES

The principal statutory provisions involved are §§167 and 221 of Chapter X of the Bankruptcy Act (11 USC §§567 and 621), set out at App. 32a - 33a.

STATEMENT OF THE CASE

This is a proceeding under Chapter X of the Bankruptcy Act. The debtor, organized in 1954, was a pioneer in roll-on roll-off ("fishy-back") water transportation; freight is shipped door-to-door overseas in highway trailers carried on trailerships. These trailerships are towed by rented sea-going tugs. Self-propelled vessels, now lost in foreclosures, were planned and instituted.

In less than three years from incorporation of the company until this reorganization proceeding began in 1957, more than 4,000,000 shares of its common stock reached the public at prices of from $1.00 to $4.00 per share, almost half of this through insiders who unloaded at substantial profit to themselves. When the proceeding started there were over 7,000 stockholders. At the time of these sales a speculative market had been created for the stock, in part by a large amount of publicity given to the "fishy-back" method of shipping and to the self-propelled trailership "Carib Queen", an LSD being converted under Mari-

time Administration guarantee. A boiler explosion on the Carib Queen's maiden voyage to France precipitated these proceedings (I 256-286).

The recurrent theme of this reorganization is of its ever bolder domination by those who wrecked the old company, encouraged by the repeated failure of the courts below to stop them. The trustee produced three successive reorganization plans, each opposed by the petitioner Committee and the Securities and Exchange Commission: two since set aside, the third so far sustained. The Committee has contended throughout:

1. that if valued in accordance with controlling decisions of this Court, the estate was solvent;

2. that there has been failure to investigate (under §167) allegations of fraud, conspiracy and other misconduct on the part of two dominant creditors—

   a) the holders of eve-of-bankruptcy mortgages on the operating vessels, who were in fact acting as cover for the old company's financial advisors, Joseph Abrams and Arthur Shaffer, and their affiliates ("Shaffer-Spitzer")[2]

[2]This group referred to herein as "Shaffer-Spitzer" after the names of substitute indenture trustees is also sometimes referred to in the record as the "Caplan" group after the original indenture trustee. The identities of the principals were hidden behind cloaks but were ultimately conceded to be: Abrams, convicted of fraud against the United States and securities frauds; Shaffer; Dr. Robert Erdman, convicted upon plea of guilty to bribing a federal judge in a bankruptcy case; and some lesser lights. Abrams and Shaffer had floated

b) the largest single creditor, the shipyard which converted the company's principal vessel, whose explosion at sea was the immediate cause of the reorganization ("Merrill-Stevens").

The Committee has also contended from the time of the proceedings on the second plan

3. that the stockholders are entitled to creditor treatment by reason of frauds in the flotation of the stock; and

4. that the proceedings were tainted by the trustee's evident lack of independence.

The first Plan: control to Shaffer-Spitzer—The trustee's first (1959) plan of reorganization gave complete control of the debtor to Shaffer-Spitzer. After formulating the plan, the reorganization trustee resigned to become president and a director of the reorganized debtor with stock options (II 525). By a $100,000 under-the-table side-deal, illegal under §221(3) and (4) of the Bankruptcy Act, Shaffer-Spitzer bought the consent of Merrill-Stevens.[3]

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most of the company's stock to the public. Abrams' 1957 conviction for defrauding the United States, I 258, Facts on File 1961-31D2; Abrams' 1962 conviction for bribery in a securities fraud case was reversed on an evidence ruling and presumably will be retried, New York Times Index 1964, p970; Abrams' conviction in an additional securities fraud, ib; related frauds by Abrams are also involved in *Ashbach v. Kirtley*, 289 F2d 159 (CA8, 1961), *Kirtley v. Abrams*, 299 F2d 341 (CA2, 1962). Erdman's testimony as to his bribery, New York Times Index 1962, p510, and his guilty plea and sentencing, ib. 1964, p510.

[3]An interim trustee, on discovery of the deal, petitioned to vacate confirmation, and was supported by the SEC and the Committee. The District Court refused to vacate the plan. An appeal was taken by

The stockholders were excluded from participation by a determination of insolvency reached without any proceedings on the record whatever (I 34). The Committee, with the support of the SEC,[4] appealed (I 206). The trustee moved unsuccessfully to dismiss the appeal as frivolous, and then moved in the District Court for immediate consummation.

At this point the SEC submitted to the District Court sworn evidence that the Shaffer-Spitzer group were not the innocent independent mortgagees that the trustee had insisted on believing them rather than investigate the Committee's charges. The trustee then belatedly investigated that part of the Committee's charges and found that the Shaffer-Spitzer mortgage was a fraudulent transaction by insiders who had wrecked the company and defrauded the public stockholders in violations of the federal securities laws.

Withdrawal of the first Plan — The trustee moved to withdraw his plan as not fair and equitable (I 294), to contest the mortgage claim by setoff and counterclaim and to institute suits against Abrams, Shaffer and Erdman and perhaps others (I 286,291).

The District Court vacated the plan: Shaffer-Spitzer

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the interim trustee but withdrawn. The District Court removed him and reinstated the prior and now still-serving trustee (I 39-40, SEC 194-203).

[4] "We believe that the procedure adopted by the District Court violated basic safeguards provided by Chapter X for the protection of public investors and avoided the careful machinery set up by Congress for the consideration and effectuation of a plan of reorganization" (Response of SEC in Opposition to Trustee's Motion to Dismiss Appeal, Nov. 25, 1959, p3.)

cross-appealed. The Fifth Circuit upheld the District Court's vacation of the plan and held moot the issues raised by the Committee's appeal from confirmation, so that the questions of valuation procedure and absence of §167 investigation were not decided. *TMT v. Anderson*, 292 F2d 455 (1961), pet. by Shaffer-Spitzer for cert.den. 368 US 956.

The stockholders' right to creditor treatment — After his investigation the trustee had proposed, as a result of the Shaffer-Spitzer securities laws violations, to recognize the public stockholders as creditors entitled to participate ahead of the violators (II 1096). The same facts of conspiracy in securities law violations by the company with these insiders grounded the Committee's assertion of a right of defrauded stockholders to participate in the reorganization as creditors. The SEC supported both the principle of the claim and a right to a hearing on the merits (II 1093).

The second plan: control to Merrill-Stevens — The Committee's initial charges against Merrill-Stevens reinforced by the SEC's detailed objections to the claim (I 130; II 1041-2, 1094-5; III 405) produced no investigation. By further documentation before the second plan was promulgated the Committee had shown, in addition to what the SEC had shown, serious contract violations and substantial proof of responsibility for the boiler explosion of the Carib Queen. The Committee also showed reason to investigate Merrill-Stevens' participation with Shaffer-Spitzer and the old management in defrauding the Maritime Administration and rigging the market for the stock being floated by various devices (including the obtaining of a publicized loan guarantee by fraud on the Maritime

Administration (II 1042-1072.4). Although the SEC advised the District Court that these charges required answer and hearing, no hearing was ever had (II 1073).

Notwithstanding the uninvestigated charges of fraud and conspiracy against Merrill-Stevens, the trustee's second (1962) plan gave control of the company principally to Merrill-Stevens (2 places on a board of 7), along with the trustee himself and his general manager (II 297-8) and subsidiarily to a towing company on whom he had bestowed a sweetheart contract for towing (granted above an actual received bid and in the absence of fair opportunity to bid competitively (II 946-954, III 94-6), and to interests affiliated with the trustee's insurance broker (III 353-4), both of whom were heavy buyers of smaller creditors' claims at a large discount (II 261,867,911,938; III 322). The reorganization trustee was again to be president and chairman of the board (II 695,707,987), with a long term contract and formal assurance (or in a later modified version, practical assurance) of substantial stock options (II 274,276-7, 296-9).

Shaffer-Spitzer were not cut out. The "compromise" treatment accorded them is set out below.

The stockholders were again excluded by a determination of insolvency, in proceedings which were conducted in express repudiation of controlling doctrine of this Court as to valuation (infra p 17-18).

The stockholders' claim to creditor treatment was rejected without hearing on the merits (or on the issue of laches later relied on) although the trustee had previously, as recited above, supported the principle of the claim. No

response was ever filed to the Committee's proof of claim; a response filed to the individual stockholder's claim was never noticed for hearing (II 4).

The Committee's appeal from the second plan was supported by the SEC on every major issue. The United States as a creditor appealed because its absolute priority was denied. The Fifth Circuit, sustaining the government, reversed and remanded. *United States v. Anderson*, 334 F2d 311, pet. for cert. (by the trustee) den. 379 US 879. Because a remand was thus necessary, the Fifth Circuit found it unnecessary to decide the issues raised by the stockholders, except that it gave advisory guidance on one point, holding that the trustee was not ipso facto disqualified from the presidency, although he would be if the proponents of the plan assured him of "emoluments and security". *In re TMT Trailer Ferry, Inc.*, 334 F2d 118, 119, 120.

The Committee and the SEC then sought clarification of the Fifth Circuit's remand order, on the ground that there was danger that the trustee and the District Court would misconstrue the Fifth Circuit's failure to deal with the bulk of the Committee's contentions as a rejection of those contentions. The Fifth Circuit declined clarification and trustee and District Court proceeded to make the misconstruction feared. All proceedings on the third plan were conducted on the utterly erroneous view that every contention of the Committee was barred by the law of the case (e.g., III 264,269,388-9,391-3).

As will be seen, the Fifth Circuit, on later appeal, expressly held that its decision had indeed been misconstrued. As will be seen also, the Fifth Circuit nevertheless failed to

remedy the numerous serious errors committed by the District Court in misplaced reliance on the wrong construction it had placed on the Fifth Circuit's decision.

That was the background against which the third plan was formulated and the decision of which we seek review was made.

The third Plan: control again to Merrill-Stevens, without hearing on new challenges — The third (1965) plan recognized the full priority of the government claim, although trustee and District Court had previously asserted that to do so made the plan of reorganization not feasible.[5] In other respects, the plan was substantially the same in form as the second plan.

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To identify separately some of the more remarkable features of this reorganization: —

1. *The refusal to investigate responsible charges of fraud* — On the first appeal, the Fifth Circuit held the issue as to lack of §167 investigation (and other matters) moot because the trustee had pending the appeal investigated and been forced to acknowledge that the charges against one of the creditor groups, Shaffer-Spitzer, had been fully substantiated (supra, p 3).

Lack of investigation and hearing on the Committee's fraud and conspiracy charges against Merrill-Stevens,

[5]A new bank loan to pay off the government, requiring debt service in excess of the trustee's and District Court's projection of earnings, is discussed below in its effect on affiliations under §221(4) and (5).

summarized above, was urged as error on the second appeal. This was one of the contentions that, as stated above, the Fifth Circuit found it unnecessary to decide because of the reversal and remand of the plan for other error.

The Committee (correctly as later held) considered the issue open, and on remand the Committee again pressed these charges in the District Court and attempted to supply even more evidence in support by requesting discovery procedure for documents the trustee had said he could not locate (III 19,85; 16-20). The Committee located these documents in third party (government) hands, and pinpointed them by dates, file number and description of contents (III 310-316).

Consistently applying its erroneous conception of law-of-the-case already noted, the District Court refused the discovery procedures to bring the incriminating documents into the record, on the ground that the issues involved had been conclusively determined against the Committee in the second appeal (III 73,85-6,339-340,346), and discharged the Committee for its recalcitrance in persisting in relitigating the foreclosed issue (III 350-351,368, 388-9). These rulings too the Committee appealed in the third appeal.

Since the Committee's charges of fraud and conspiracy were rejected by the District Court, whose rulings were allowed to stand in the final appeal, it is important to make clear that these were not rash and irresponsible charges: —

—The SEC, charged with statutory responsibility for advising the court in reorganization matters, conducted its own investigations and either expressly concurred in the

Committee's charges and conclusions or expressly advised the District Court that the Committee had made out a prima facie case requiring the adversary parties to go forward with rebuttal and expressly argued the necessity of hearing on the charges. On this major issue, the SEC has supported the Committee in three rounds of appeals.

—The Committee's charges against Shaffer-Spitzer were rejected by the District Court and derided by the trustee as frivolous. Their truth was demonstrated and the trustee was forced to eat crow.

—The Committee's detailed specifications of charges against Merrill-Stevens have never been controverted. The only defense has been the now untenable one that the Committee had no right to litigate this issue.

2. *Refusal to investigate charges of improper affiliations* — As already noted, in three successive plans, the trustee emerged as president and director with a contract and definite or at least practical assurance of stock options.

On the second plan round of appeals, the Fifth Circuit held that the trustee need not as a matter of law be prophylactically barred from presidency of the reorganized company.[6] At the same time, however, the Fifth Circuit

[6]The SEC Advisory Report on the second plan had stated: "The independence and impartiality of the trustee is the very essence of the reorganization process under Chapter X, and must be strictly maintained throughout the proceeding. The prospect of the trustee obtaining a remunerative position with the reorganized company after termination of the trusteeship tends to impair the disinterestedness required of him as trustee. *** The provision in the plan to permit the trustee to serve as president of the reorganized company is clearly improper" (II 743).

held that he would be barred if the proponents of a plan "assured him of emoluments and security rather than merely nominating him for approval by the court and subject to the usual control of the Board of Directors" 334 F2d at 119-120.[7]

Since the Committee believed that just such improper assurances were given and that the trustee had not displayed the required "forbearance of all opportunities to advance self-interest that might bring the disinterestedness of [his] administration into question", ib., the Committee renewed, in proceedings on the third plan, the issue thus expressly held open. The Committee's objections to the plan called upon the District Court to investigate on the record, among other things, promises and payments and affiliations centering around the trustee, because of the relationship of the trustee, on the one hand, to a banking group with the power of life and death over the reorganized company, and, on the other, to the creditors given control notwithstanding uninvestigated charges of fraud and notwithstanding uninvestigated charges of improper patronage (III 244-5). The objection, authorized by the Fifth Circuit decision and by §221(4 and 5) of the Act, was rejected by the District Court without investigation (III 264,269)—another application of the District Court's erroneous conception of "the law of the case".

3. *Improper purported "compromises"* — The Shaffer-Spitzer claim was "compromised" in the first plan by giving them complete control of the enterprise. When inves-

[7]The broader position that the trustee is ipso facto barred will still be open if certiorari is now granted, for the ruling was not final until embodied in the present plan, Stern and Gressman, *Supreme Court Practice* (3d ed. 1962) 18.

tigation was compelled, the trustee withdrew the plan and recommended that the Shaffer-Spitzer claim be "disallowed in toto" or subordinated to claims of general creditors including stockholders who were sold TMT stock in violation of the Securities Acts (II 1096).

Nevertheless, in the second and third plans, the Shaffer-Spitzer claim was purportedly "settled" by allowance as a priority claim in the full amount of the $280,500 cash they had paid for both their egregious mortgage and for 10,000 shares of bonus stock, together with allowance as an unsecured claim of "back interest" from 1958, accruing at $16,000 per year, a unique allowance in this reorganization (I 275,286; II 289,384). Established setoffs and counterclaims (II 1092) were not asserted against them and while one suit was started, others affirmatively recommended by the trustee were not. Three years later (with statutes of limitation running all the while) the trustee for the first time admitted that utter abandonment of these suits had been part of the deals with Shaffer-Spitzer and also Merrill-Stevens (III 192-3): but this off-the-record understanding never appeared on the face of the plan either at that time or in the parallel provision of the third plan.[8]

The Merrill-Stevens claim was "settled" in the second plan by allowance in full amount to the penny, dropping the allegedly secured portion to unsecured status (II 702). But as the SEC pointed out (II 740) the waiver of secured status in this case represents no "compromise";

[8]The SEC's Advisory Report on Plan II observed: "In the light of the trustee's report, the treatment of the Caplan mortgage is not fair or proper. There is nothing in the record to justify the trustee's retreat from this prior position in his report" (II 739).

thereby Merrill-Stevens achieved control. There had been no hearing on the serious and substantial objections, set-offs and counterclaims against Merrill-Stevens (supra); no marshalling; no ruling on the contention made by the government and other creditors that it had no valid maritime lien at all. The basis for this "settlement" was never disclosed on the record. To borrow the SEC's Fifth Circuit brief characterization of this compromise: "wholly unjustified" (Br. in #19,996, p33).[9]

The stockholders appealed, attacking the propriety of the "compromises" made without investigation and without hearing, and were supported in this by the SEC. This was another issue which the Fifth Circuit, in the light of the remand, found it unnecessary to determine.

In the proceedings on the third plan, we accordingly renewed the attack on the Merrill-Stevens "compromise". As already noted, the District Court refused discovery procedures but now held that nothing had "been presented by way of evidence or otherwise to change the opinion of the court expressed in its orders in 1962 overruling those contentions." (III 243,263-4).

4. *Refusal to hear stockholders claim to creditor treatment* — This claim (supra),[10] initially acknowledged by

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[9]"Since the effect of both plans [internal and cash plans] is to exclude the stockholders on an inadequate valuation record, and in the light of the treatment of the Merrill-Stevens claims and the Caplan [Shaffer-Spitzer] mortgage, neither plan is fair and equitable" (SEC Advisory Report. II 741).

[10]The Committee's articulation of the claim took the form of a Statement of Position, served on all parties and presented to the District Court in March 1961, even before the remand on the first plan. In the Statement the Committee, among other things, applied for extension

the trustee, supported in principle by the SEC, was rejected in the second plan without any response to the Committee's proof of claim and repeated earlier assertions of the claim, nor any hearing on a motion to dismiss the individual stockholder's assertion of the claim. On appeal from the second plan, the issue was again one of those never reached in view of the remand for other error.

In proceedings on the third plan, efforts to reassert the claim (III 242-243) were passed over, again on the mistaken ground that the previous rejection without hearing had obtained appellate court approval (III 263-264,269).

5. *Valuation based on explicit repudiation of controlling requirements of this Court* — The Committee objected to the income and expense figures used in the District Court's valuation because they were uncorrected for milking, cost padding and other downward distortions, and because the Committee was not permitted normal examination of these matters. Details are too complex to be set out here, but on the even more fundamental issue of the District Court's insistence on a flat projection of current earnings unadjusted for presently visible

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of time for filing claims. In April 1961 the District Court denied leave to file, without prejudice to the Committee's right "to present its views at the proper time in the course of these proceedings" (II 861, 962, 1037 ff).

Later, in 1962, when the second plan was in the making, the Committee restated this contention in Suggestions for the Formulation of a Plan (II 1083), and at the suggestion of trustee's counsel incorporated it in Proposed Amendments to the Plan (II 1087). The claim was reiterated in Objections to the Proposed Plan (II 1090), and before Plan II was approved the Committee filed formal Proof of Claim (II 358) and the wife of one of Committee counsel, herself a defrauded stockholder, filed an individual Proof of Claim on behalf of herself as well as on behalf of the class (II 368).

trends of the postreorganization future including the trustee's own matured plans, we quote in footnote the SEC's Advisory Report analysis of the records.[11]

6. *The third (present) appeal* — On the appeal from the third plan the Fifth Circuit held that the District Court had been in error. In making the record and confirming the plan in disregard of each of the stockholders' objections described above, the District Court had wrongly foreclosed basic contentions "not in terms discussed and decided" in the earlier appeal, 364 F2d at 939. Neverthe-

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[11] "The approach to valuation by the District Court, as well as by the Trustee, was unduly restrictive. Both used the latest available actual earnings as estimates of future earnings. Indeed, the insolvency order recites that the "only reliable factors are what the Debtor is doing now". As a result, no consideration was given, for example, to future growth of the Debtor's business, the likelihood of which was then clearly indicated. While the District Court said that the effect of increasing the fleet of vessels and truck trailers was "too speculative and uncertain to warrant consideration," the increasing volume of business on hand justified the Trustee's acquisition of additional vessels and vehicles, and, in fact, such additional acquisitions were authorized by the Court before and since the entry of the insolvency order. [*Footnote:* Since the valuation hearings in 1962 the fleet of vessels has increased from three to five and truck trailers from 350 to 670.] Burl E. Thouvenelle, the Trustee's general manager, under whose direction all the Trustee's financial exhibits were prepared, testified that, based on information then available to him, he was able to make a projection of changes in revenues, expenses and profits if additional vessels were acquired, but no such projection was ever made" (III 229-230).

"In view of the inadequacy of the record, there is no reliable basis upon which to resolve the question of valuation. From the viewpoint of the stockholders, the problems of valuation, and the related issue of insolvency; are all the more acute since the plan allows, without any hearings, some $2,000,000 in claims as to which there are substantial disputes. A reduction or disallowance of these claims, in whole or in large part, would by corresponding amounts reduce the valuation required for establishing solvency. There is, accordingly, no adequate support in the record for the exclusion of the stockholders under the plan" (III 235).

less, the plan was allowed to stand and the stockholders were left without remedy. In this, the Fifth Circuit failed to exercise a needed supervision and came into conflict with controlling decisions of this Court and with decisions of the other circuits as we shall show.

REASONS FOR GRANTING THE WRIT

On several issues of importance in the administration of Chapter X, the decision below as we shall briefly show is in conflict with controlling decisions of this Court and with decisions of other Courts of Appeal. But these errors have a relationship more important than the errors themselves.

The crux of this case is conspiracy to defraud. The principals of the conspiracy were major creditors of the debtor and management.

Investigation of the conspiracy was suppressed by a trustee whose personal ambitions were furthered by the suppression.

The suppression of the investigation was countenanced and favored by the District Court.

The Court of Appeals has failed to exercise the supervisory control that it is charged with exercising over the District Court.

The Southern District of Florida has not succeeded in maintaining flawless supervision over the office of reor-

ganization trustee.[12] But the reorganization statute was intended to provide protections that would make it unnecessary for grand juries to determine whether conduct was criminal or merely inept or greedy. This case displays an erosion of those protections to the point where the reorganization scandals of the 1930's have returned in classic form. It exhibits with dramatic fidelity the features reported by the SEC in its fundamental study 30 years ago:

> "The emoluments of control are the stakes of reorganization. Control means profits and protection. He who controls the reorganization controls in large measure the assertion of claims based on fraud or mismanagement which the company or the security holders may have against the management or the bankers. *** He who controls the reorganization controls the dispensation of the vast amount of business patronage present in any reorganization. *** He who controls the reorganization dominates the selection of the new management of the company." SEC, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part I, pp4-5 (1937).

The recognition of these and other dangers in reorganization procedures of the 1930's led to fundamental reforms. The first was the requirement of the independent trustee. The second was the requirement of independent trustee investigation. The third was the establishment of

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[12]See the indictment of C. Palmer Parker, reorganization trustee, for arranging sale of a debtor's property to an enterprise in which he had an interest, Miami Herald, September 30, 1966. See also the Fifth Circuit criminal contempt citation of Irwin Ray, reorganization trustee, for commingling funds, docket Number 23891. Cf., Miami Herald, November 6, 1966. Cf. the series of articles ib., November 21-25, 1965, on local bankruptcy matters.

the advisory role of the SEC. Beyond that, the historic requirements of objective valuation by capitalization of businesslike projection of future earnings, of the recognition of the vital role of the independent security holder and the independent security holders' protective committee, and of on-the-table proceedings, rather than under-the-table deals, were all retained.

Each of these protections has been violated in this case, in a manner that sets a pattern easy for others to follow in the future, and that will be followed if this case stands. On the other hand, the case presents for authoritative disposition a paradigm of basic corrections needed to put reorganization back on course.

The violations are not several. They are integrally related to the common fact that the emoluments of control are the stakes of reorganization: for a personally ambitious trustee, for the trustee's patronage beneficiaries, for defrauding creditors who support and are protected by the trustee.

Sed quis custodiet ipsos custodes? Even though the trustee commits no crime, if he is self-serving, and the court who appointed him will not call him to order but good humoredly acknowledges that "he would be perhaps inclined to lean to his employment" (II 331-332), then the appellate courts must, or there is an end to honest reorganization.

I. *The Fifth Circuit's failure to require the District Court to investigate alleged improper affiliations of its trustee defeats the proper administration of Chapter X in a respect so fundamental as to require review under*

Rule 19(b) — The trustee is the "focal point" of a Chapter X reorganization; his functions are "difficult to over-emphasize" (H.Rep.No. 1409, 75 on Cong., 1st Sess. 43.44 (1937). The *independent* trustee "is the key to real reform. In comparison, the other reforms are secondary" (SEC Commissioner Douglas, in hearings before the House Committee on the Judiciary on H.R. 6439, reintroduced with amendments as HR 8046, 75th Cong. 1st Sess. 177 (1937)).

Only through an impartial and independent trustee can the court be in a position to exercise "an informed judgment and to afford a critical scrutiny and supervision of the estate at all times" (H.Rep. No. 1409, supra at 43).

A trustee chooses, and seeing through the trustee's spectacles, the court chooses.

In this case, the trustee chose:

—to urge an "internal plan" that gave him tenure rather than a "cash plan" that would not

—to discourage outside bidders who expressly stated they had not named their top figure for the company, by announcing in advance his preference for the internal plan and by withholding information

—to discourage outside bidders for the towing contract by refusing a copy of the contract they were bidding for and by treating them so repellently that they refused to deal further with him

—to not investigate (until confronted by the SEC with affidavit proof) pointed charges against Shaffer-Spitzer, who had first nominated him to the presidency

—to not investigate at all documented charges against Merrill-Stevens or even look at documents he had never seen which were alleged to establish their guilt

—to "compromise" away major causes of action of the debtor which he himself had established as worth pursuing, at 0 cents on the dollar in off-the-record negotiations

—to refuse to provide for stockholders' claims based on fraud, although he himself had established the basic facts on which they rested and had acknowledged their equity and right to recognition

—to arrange bank loans admittedly crucial to feasibility on terms conditional either on his own retention, or later, on management satisfactory to interests allied with himself, without attempting to get such loans from independent sources.

In addition to such major decisions, there are many more, individually smaller, but in the aggregate making up the tissue of the reorganization—whether to investigate under §203 the acquisition of small creditor's claims by insiders (he chose not to); whether to supply information needed by the Committee and by others (repeatedly he chose not to); whether to acknowledge the existence of his own existing program for improving the operation, or more basically, whether to postpone part of this program deliberately in the hope that it would become effective only after termination of the reorganization (he repeatedly chose not to acknowledge his plans when they existed, and did deliberately postpone them because in his general manager's words, he did not wish to mortgage "the future for the benefit of the past" (III 143,145)).

" . . . the incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent", *Woods v. City Bank Co.*, 312 US 262, 268 (1941).

"Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting", *Mosser v. Darrow*, 341 US 267, 271.

" . . . . no matter how impartial and disinterested a trustee may be at the outset, if he hopes for a job in the future for himself, or for his relatives, or friends, he is apt to play 'power politics' and to align himself with the interests which seem most likely to succeed in controlling the debtor after reorganziation or with those who are most willing to make provision for him in the future. If a trustee, with an eye to the future, is to be allowed to sit in the place of a disinterested and impartial judge and reconcile conflicting plans of reorganization between the various classes of security holders, his prescience is apt to concur with his aspirations for the future", Jackson, *The Relationship of the Trustee in Reorganization under The Chandler Act*, Am. Bankr. Rev., p117, De. 1939, quoted from SEC brief in the appeal on Plan II.

That is what happened here.

It does not follow of course, that an independent trustee could not conceivably have reached the same result, although we believe he could not. But enough has been shown to require imperiously, in the interest of the integrity of the reorganization process, that such matters be inquired into and disposed of in an open manner on hearing.

Accordingly, when the Fifth Circuit remanded but expressly held open the question whether there had been assurances of emoluments and security to the trustee which might bring the disinterestedness of his administration into question, we returned to the District Court, and explicitly referring to this branch of the decision (III 245) we sought investigation under §221 (4 and 5) of all promises and payments in connection with the plan and of all affiliations of management, specifying topics to be investigated and grounds for questioning them (III 244-5). This was refused without hearing (III 263-4,266-7,269) basically on the ground that the issue was foreclosed: "The last two decisions of that court [Fifth Circuit] referred to above and decided June 1964 appear to have settled all issues under the present plan of reorganization other than the question of its feasibility ***" (III 269).

The Fifth Circuit on appeal from this ruling acknowledged that the Committee had indeed been right in believing the issue open. Its failure to require record investigation of our charges against this court officer, under these circumstances, was a recusation of its supervisory responsibility.

The Fifth Circuit, has here, in the terms of warrant for

certiorari, Rule 19(b), "so far sanctioned a departure by the lower court *** from the accepted and usual course of judicial proceedings *** as to call for the exercise of this court's power of supervision".

We must however recognize that the Fifth Circuit considered the failure to take charge of this situation was justified on certain grounds. Before proceeding to discuss certain individual matters on which the decision below is in conflict with decisions of this Court and of other circuit courts, it is appropriate that we examine the analysis that led the Fifth Circuit to this result.

The court's analysis was as follows:

Notwithstanding the recognition that the District Court was in error in holding the stockholders foreclosed from raising the points raised here ("I. Prior decision", ~~354~~ 364 F2d at 938), the Fifth Circuit ruled that the stockholders did not have a right to participate in the estate either as creditors or by reason of solvency. It held ("II. Stockholders as creditors", ib. at 939) that the stockholders are not entitled to recognition as creditors because of delay in asserting the claim, and ("III. Solvency or insolvency", ib. at 940) that the stockholders are similarly not entitled to share by reason of an equity in a solvent estate: "The finding of insolvency cannot be held clearly erroneous". Subsidiarily, in reaching this result the Fifth Circuit also sustained the compromises at full value of approximately $2,000,000 of seriously disputed claims out of $5,400,000. The Fifth Circuit said that it was extremely unlikely that disallowance of one or both compromises would have re-

sulted in solvency. The creditors, the Fifth Circuit noted, did not object. Thus, the Fifth Circuit concluded, the stockholders have no further interest and no standing to complain. Finally, the Fifth Circuit declared: "This nine-year-old litigation must at long last be brought to an end".

There is a dangerous circularity in this reasoning: to take just one branch of the argument, we have no standing because the estate is not solvent; therefore we need not be heard on our contention that the valuation proceedings were wholly vitiated by a self-serving trustee's withholding of crucial facts and misrepresentation of others, nor on our contention that crucial evidence was excluded by procedures at odds with controlling law. Since we are not to be heard to raise these questions, the proceedings below cannot be held clearly erroneous, and thus we have no standing.

II. *The decision that lack of standing by the Committee would bar inquiry into fairness of the plan is contrary to Comstock v. Group of Institutional Investors, and other cases* — Assuming arguendo that the Committee has been validly counted out, and that it is significant that the creditors did not speak out, matters to which we will return, nevertheless the issues we have brought forward must be heard even if we needn't be heard.

§206 of the Act, giving stockholders an absolute "right to be heard on all matters" was an intentional broadening of the prior law, 8 SEC, Report, supra, p193 (1940). The decision of the Fifth Circuit, countenancing the silencing of the stockholders because of the District Court holding that they are not to participate, is contrary to that of the Fourth Circuit in *Committee for Holders, etc. v. Kent,* 143

F2d 684 (1944). *Collier on Bankruptcy* §§7.18 and 9.23. Even if stockholders cannot speak for themselves they may speak for public policy and the prevention of fraud.

The reorganization court is required to be—

> "diligent to protect itself and the public from approval of unfair plans, even by default, and may take for its own use evidence no party would have a right to force upon it", *Comstock v. Group of Institutional Investors*, 335 US 211, 226-228; dissent in agreement on this point at 235.

Cf. *Young v. Higbee Company*, 324 US 204, 214, where it was held that an equitable defense against a person making a contention on behalf of a class in a reorganization does not preclude relief to the class.

Even if, contrary to our contention, the stockholders' Committee was barred by laches, the issue of the stockholders' right to creditor treatment under the circumstances (initially acknowledged as valid by the trustee, fully supported in principle by the SEC) was one that went to the essential fairness of the plan. It was the District Court's duty to hear it on its merits, laches or no.

Similarly, even if indeed the creditors did not object, the issue of the alleged improper character of major settlements made by the trustee off-the-record went to the essential fairness of the plan. It was the District Court's duty to hear it on its merits on-the-record, solvency or not, and whether other creditors were too cowed to object or no.

Above all, the challenge to the integrity of all of the

trustee's proceedings in the light of his evident personal advantage from each major decision he made (a challenge supported by the SEC) went to the essential fairness of the plan that resulted and to the essential protection of the court's process. It was the District Court's duty to examine on-the-record our specifications of alleged improper affiliations, whether we had standing or no. The Fifth Circuit's failure to hold the District Court to that standard was another recusation of its responsibility of supervision.

III. *The decision that failure of creditors to object bars inquiry into fairness of the plan is contrary to Case v. Los Angeles Lumber Co.* — The Fifth Circuit in rejecting our attacks on the compromises and on the related valuation thought it "significant that not a single creditor has ever complained of either compromise. The only criticism has come from the stockholders' Protective Committee supported by the Commission", 364 F2d, at 941. But even though only a trivial fraction of the creditors objected (R 324,326), this Court has held that overwhelmingly heavy acceptance by creditors will not cure a plan in conflict with the Act's basic requirement of fairness. *Case v. Los Angeles Lumber Co.* 308 US 106.

Indeed this principle was acknowledged at an earlier stage of this very proceeding, *TMT Trailer Ferry, Inc. v. Anderson*, 292 F2d 455 (1961), cert.den. 368 US 956, where the Shaffer-Spitzer plan (eliminating stockholders), was held subject to being set aside and was set aside although all creditors had concurred and only the stockholders' Committee and the SEC objected, as here. The United States as creditor initially also objected, but

withdrew its objection in order to accept a settlement of 30 cents on the dollar (II 563); it has since, by virtue of our sucessful opposition to the plan to which all creditors consented, received one hundred cents on the dollar.

IV. *The failure to require investigation of serious charges of fraud and conspiracy among major creditors and management is in conflict with decisions of the Third, Fourth and Sixth Circuits* — Particularly, because, as shown above (pp. 8-13) creditors under fraud charges wound up in control, the failure of the District Court to order investigation of these charges passes any reasonable boundary of discretion. Investigation under §167, although discretionary in form, is mandatory in fact where there are fraud charges against dominant creditors. 6 *Collier on Bankruptcy* ¶7.18. The decision here conflicts with the views of the Sixth Circuit, *Gochenour v. Cleveland Terminals Bldg. Co.*, 118 F2d 89 (1941); Third Circuit, *Philadelphia & Reading Coal Co.*, 105 F2d 354 (1939); Fourth Circuit, *Committee for Holders, etc. v. Kent*, supra. Cf. Seventh Circuit, In re *South State Street Bldg. Corp.*, 105 F2d 680 (1939).

V. *The failure to require hearing of the stockholders' claim to creditor treatment is in conflict with Czaplicki v. The Hoegh Silvercloud* — The Fifth Circuit sustained on the ground of laches the District Court's refusal to hear the stockholders' claim to creditor treatment. The substantive issue is novel and potentially very important. It may prove to be a valuable adjunct to the armory of enforcement of the securities laws. It does not appear to have arisen before in the context of a reorganization plan, but has substantial precedent in related fields of law. It is fully supported in

principle by the SEC, which also supported the position that the issue was raised in timely fashion.

Very briefly put, the Committee and an individual stockholder on behalf of herself and all similarly situated, assert a conspiracy between the debtor, its financial advisors and their affiliates (Shaffer-Spitzer) and the shipyard (Merrill-Stevens) to float stock (issued in violation of the Securities Act of 1933) in a market fraudulently manipulated in violation of the Securities Exchange Act of 1934.[13] As a result of such manipulation, the defrauded stockholders are entitled, it is argued, to rank in a reorganization as general creditors and in any case ahead of the defrauding creditors. *Oppenheimer v. Harriman Natl. Bk. & Trust Co.*, 301 US 206.

The whole idea of laches is erroneous in fact, for we have already shown that the stockholders raised their creditorship claim early and often (supra, p 16n). The Fifth Circuit's misreading of the record in that respect is of course no ground for certiorari, but it results from a procedural oversight that amounts to a clear denial of fair hearing. The issue of laches, although raised by the trustee in a pleading addressed to the individual claim at the time of the second plan (none was ever addressed to the Committee claim), was never brought on for hearing before the District Court: the District Court decided it against the

[13]The manipulations included such matters as the distribution by the debtor of misleading offering circulars, misleading financial statements overstating assets, lack of disclosure that the certifying accountant was not independent, use for stock publicity purposes of the Carib Queen on a dangerous voyage without exercising care to ascertain seaworthiness, issuance of stock on the basis of a false and fraudulent appraisal publicized by the debtor as a valid and independent one, and many others (II 365-367).

stockholders peremptorily in the order confirming the plan. This was one of that large crowd of District Court errors never ruled on by the Fifth Circuit in the appeal from the second plan, but, as already many times shown above, erroneously deemed by the District Court to be impregnable law of the case at the time of the third plan. By disposing of so important a point of substantive reorganization law as the stockholders' creditorship claim, in an ex parte finding of laches without ascertaining in an orderly way by proof what the facts on laches are, the Fifth Circuit is in conflict with the teaching of *Czaplicki v. The Hoegh Silvercloud*, 351 US 525, 533-534. Cf. also *Baker v. Nason*, 236 F2d 483, 493 (5thCir.1936).

ADDITIONAL REASONS

Space does not permit us to expand on other reasons for granting the writ; but if certiorari is granted we propose to brief also the conflict of the decision below with the law of reorganization compromise and valuation procedure as stated by this Court and other circuits. Other circuits reverse for accepting Chapter X compromises on far more record information than the off-the-record reports (II 25, 283-4) tendered by the trustee here. *Conway v. Silesian etc. Co.*, 186 F2d 201 (2ndCir.1952); *Ashbach v. Kirtley*, 289 F2d 159 (8thCir.1961). Cf. General Order 33, 52(2); *Consolidated Rock Co. v. DuBois*, 312 US 510, 523; *Matter of Natl. Public Service Corp.*, 68 F2d 859 (2ndCir.1933), cert.den. 292 US 1; *Taylor v. Standard Gas etc. Co.*, 307 US 312, 323.

As to valuation, the errors of detail such as cost padding (supra, p 17) would not by themselves merit certiorari review. But the District Court's insistence on making a

purely retrospective valuation[14], approved by the Fifth Circuit on the complacent ground of trial court evaluation of witnesses, ~~254~~ F2d at 940, is not the familiar and authorized weighing of credibility and qualifications but the acceptance of evidence that departs from, and the rejection of evidence that obeys, this Court's command that valuation not so confine itself to the past. *Galveston, H & S.A.R. Co. v. Texas*, 210 US 217, 226; *Institutional Investors v. Chicago, M.St. P. & PR.*, 318 US 523, 540, 542 (1942); *Consolidated Rock Prod. Co. v. DuBois*, supra, p34.

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CONCLUSION

Over and above all of the specific errors are the basic major dangers to which the decision below gives added gravity:—On valuation, as on compromises, as on investigations, as on disposition of claims, it is the trustee who looks and reports and frames the impression of the court. On a record demonstrating that the trustee has interests adverse to the stockholders and favorable to a group of insider creditors, that he withholds valuation facts and distorts others, suppresses investigation, gives away causes of action, makes "compromises" by secret deals, if the District Court that appointed him is not outraged and the courts of review not appalled into corrective action, no

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[14]"Let's value as it now exists [i.e., not when reorganized] to determine what should be done in these proceedings" (II. 170). "All these projections into the future are not going to bother the Court" (II. 192). "Any estimate of future earnings under different circumstances [i.e., use of equipment the trustee in fact planned to buy, etc.] of operation would be speculative and unreliable" (III. 267). "There is no possible future prospects other than what is going on" (III. 55-56). This erroneous approach permeates the entire record.

system of reorganization will achieve fair and equitable solutions.

The trustee is the administrative officer of the bankruptcy court. Both courts below have failed to accept three times tendered opportunity to check his perversion of bankruptcy administration. This, we submit, calls for certiorari review by way of exercise of this Court's power of supervision over the lower courts, under its Rule 19(b).

For the foregoing reasons certiorari should be granted.

Respectfully submitted,

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Attorney for Petitioner

January 9, 1967

[JUDGMENT OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT]

October Term 1965

No. 22,652

D. C. Docket No. 3659-M-EC Bankruptcy

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Appellant,

vs.

C. GORDON ANDERSON, TRUSTEE,
Appellee.

Appeals from the United States District Court for the Southern District of Florida

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Before PHILLIPS,* RIVES and COLEMAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here

*Of the Tenth Circuit, sitting by designation.

ordered and adjudged by this Court that the judgments and orders of the said District Court in this cause be, and the same are hereby, affirmed;

It is further ordered and adjudged that the appellant, Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc., be condemned to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

August 12, 1966

Issued as Mandate: Sep 8, 1966

[OPINION OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT]

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,

Appellant

vs.

C. GORDON ANDERSON, TRUSTEE,

Appellee

June 8, 1964 [334 F2d 118]

Before RIVES, JONES and WISDOM, Circuit Judges.

PER CURIAM: These two appeals are here consolidated. They are taken from the trial court's determination that the bankrupt is insolvent and its later order confirming a plan of reorganization. The appeals were consolidated for argument by order of this Court with Nos. 20400, 20563 and 20659, *United States v. Anderson, Trustee*, decided this day. 334 F. 2d 111. In view of the decision there rendered we remand this proceeding to the district court for a determination of the feasibility of consummating the present plan. If it be found that the present plan is not feasible, after giving to the Government the priority accorded it in the opinion in the companion case of *United States v. Anderson*, then it may be a new plan, based upon an updated determination of insolvency, can be submitted.

In light of the decision to remand this case, it is unnecessary to determine all of the several issues raised

by the appeal. However, one question was submitted by the parties, the answer to which will materially lessen uncertainty in subsequent proceedings. Prior to the approval of the plan presently under discussion contracts of employment between the major creditors and the trustee and two of his subordinates were introduced into the record as part of the plan. They were eventually stricken from the plan, prior to confirmation, and the following provision was the only allusion to the subject:

> "It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the Court."

Briefly stated, it is the contention of the appellant and the Securities and Exchange Commission that the fact that the trustee was to take over the presidency of the reorganized company vitiated the plan. It is contended that the fact that he looked forward to taking up a remunerative position with the company after it got into the hands of its creditors, gave him an interest in conflict with that of the stockholder. This conflict of interest is argued to have been fatal to the plan. We cannot agree. There is nothing presently in the Bankruptcy Law as codified or in the cases thereunder which precludes the employment of the trustee by the reorganized company. Moreover, it is the duty of the proponents of the plan, prior to its confirmation, to disclose "the identity, qualifications and affiliations of the persons who are to be directors or officers. . . ." 11 U.S.C.A. § 621(5).

However, it is our opinion that a trustee would not be

disinterested within the meaning of 11 U.S.C.A. § 558 if the proponents of a plan assured him of emoluments and security rather than merely nominating him for approval by the court and subject to the usual control of the Board of Directors. Equity must exact from its trustees "forbearance of all opportunities to advance self-interest that might bring the disinterestedness of their administration into question." *Mosser v. Darrow*, 341 U.S. 267, 271, 71 Sup. Ct. 680, 95 L. Ed. 927.

The plan is not to be rejected merely because Anderson, the trustee, would become president of the reorganized company, but the cause must be remanded for a determination as to the feasibility of the plan in the light of the Government's preferred position as established in the companion case.

REMANDED.

[OPINION OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT]

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,
Appellant

vs.

C. GORDON ANDERSON, TRUSTEE,
Appellee

August 12, 1966 [364 F2d 936]

Before PHILLIPS,* RIVES and COLEMAN, Circuit Judges.

RIVES, Circuit Judge: This is a proceeding under Chapter X of the Bankruptcy Act (11 U.S.C. 501, et seq.) for the reorganization of TMT Trailer Ferry, Inc. and certain of its wholly-owned subsidiaries (herein collectively referred to as "the debtor"). This proceeding was initiated upon the filing of an involuntary petition by certain creditors on June 27, 1957, now more than nine years in the past. It has been before this Court on several prior occasions.[1]

The Protective Committee for Independent Stockholders now appeals from an order entered on August 23, 1965,

*Of the Tenth Circuit, sitting by designation.

[1]Caplan v. Anderson, 5 Cir. 1958, 256 F.2d 416; Caplan v. Anderson, 5 Cir. 1958, 259 F.2d 283; TMT Trailer Ferry, Inc. v. Anderson, 5 Cir. 1961, 292 F.2d 455, *cert.den.sub nom*, Shaffer v. Anderson, 1962, 368 U.S. 956; United States v. Anderson, 5 Cir. 1964, 334 F.2d 111, *cert. den.*, 1964, 379 U.S. 879; In re TMT Trailer Ferry, Inc., 1964, 334 F.2d 118.

confirming an amended plan of reorganization of the debtor which excludes stockholders from any participation in the reorganized company and also appeals from five other orders.[2] The Securities and Exchange Commission is a party to the reorganization proceeding pursuant to Section 208 of Chapter X and supports the Protective Committee in certain contentions.

I. Prior Decision.

This is the second time that the Protective Committee with the support of the Commission has sought review by this Court of what is called the Internal Plan of Reorganization of the debtor. Appeals from an order confirming the plan of reorganization taken by both the United States and the Protective Committee were decided in 1964. *United States v. Anderson*, 5 Cir. 1964, 334 F.2d 111, *cert. den.*, 1964, 379 U.S. 879; *In re TMT Trailer Ferry, Inc.*, 1964, 334 F.2d 118. In the appeal by the United States, we held that the nontax claims of the United States exceeding $900,000 were entitled to priority. The record on that appeal showed that the Trustee had stated and the district court had found that the payment of even $635,000, for which the Government at one time had offered to settle, would have rendered the plan unfeasible.

In the appeal by the Protective Committee issues were presented *inter alia* as to whether those to whom stock of

[2]The other appeals are from orders entered: (1) January 18, 1965, approving the renewal of a towing contract; (2) January 21, 1965, denying the Committee's motion for production of documents; (3) May 14, 1965, sustaining objections to the Committee's request for admissions; (4) May 21, 1965, discharging the Committee as representative of stockholders as a class; (5) May 25, 1965, authorizing consummation of the amended plan.

the debtor had been sold in violation of the federal securities laws were entitled to participate as creditors, and whether the plan should be rejected because the Trustee would become President of the reorganized company. The issue last stated was decided on that appeal in accordance with the decision of the district court. The cause was remanded for a determination as to the feasibility of the plan in the light of the Government's preferred position as established in the companion case. The Court stated that, "In the light of the decision to remand this case, it is unnecessary to determine all of the several issues raised by the appeal." On remand the district court took the position that "the decisions of the appellate court sent the plan of reorganization back only for determining the feasibility of the plan in light of the preferred position of the government's nontax claims, and that by refusing to reverse this court's rulings on the issues referred to, the appellate court has in effect affirmed this court's decisions on those issues."

We do not agree, but hold that this Court's reversal of the order of confirmation left open those issues not in terms discussed and decided. *See Mutual Life Ins. Co. v. Hill*, 1904, 193 U.S. 551, 553-54; *Wolff Packing Co. v. Industrial Court*, 1925, 267 U.S. 552, 562; *Seagraves v. Wallace*, 5 Cir. 1934, 69 F.2d 163, 164.

II. Stockholders as Creditors.

In the interest of clarity, we consider first the failure of the district court to hold hearings on the claims of the Protective Committee and of Irma S. Mason, one of the stockholders, asserting a claimed right of rescission of purchasers of stock based on violations of the federal se-

curities laws and claiming that they and other stockholders holding such claims should rank as creditors in any plan of reorganization. The district court held these claims to be without merit on their face, stating its reasons as follows:

> "The Stockholders' Committee also filed a PROOF OF CLAIM FOR RESCISSION on behalf of unnamed stockholders who purchased stock of the debtor on the open market. The facts stated in this document are insufficient to show that any stockholders as a class or individually have valid claims against the debtor. Furthermore, the claim is filed too late and is vague and indefinite as to whom the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage.
>
> "Likewise, the claim filed by Irma S. Mason, wife of a member of the Stockholders' Committee, seeking to rescind her purchases of TMT stock on the open market is without merit for the same reasons. It shows that her damages, if any, are recoverable against others than the debtor."

The district court had, by an order entered February 4, 1958, fixed April 4, 1958 as the last day for the filing of proofs of claim. True, it had excepted "proofs of claims of creditors and/or interest of stockholders * * * founded upon securities." Other parts of the district court's order had pretty clearly indicated that the exception as to proofs of claim founded upon securities contemplated a contract claim rather than a tort claim or right of rescission. We think the district court properly construed its order so as

to require the filing of claims of the nature of those filed by the Protective Committee and Irma S. Mason seeking rescission to be made on or before April 4, 1958.

It is argued, however, that the bar date should not apply because many of the details which provide the bases for these claims were unknown until the report of the Trustees' investigation filed July 1, 1960. However, these claims were not filed until June 1962, almost two years after the filing of that report. No valid reason or excuse is given for the delay from July 1960 until June 1962. To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to liquidate and which might have delayed indefinitely the formulation of any plan of reorganization, would have been extremely prejudicial to the creditors. Under all of the circumstances, we cannot say that the district judge abused his discretion in refusing to extend the time for the filing of claims and in declining to consider these claims on their merits.

III. Solvency or Insolvency.

Much weight must be given to the long familiarity of the able and experienced district judge with the debtor and his evaluation of the witnesses who testified in his presence. *See Mayer v. Dolan*, 2 Cir. 1944, 145 F.2d 880, 881-82. The district judge thought it too uncertain and speculative for him to consider estimates of earnings "based on hypothetical circumstances at variance with the facts of past experience," and in so ruling he did not abuse his discretion.

In July 1962, the district court, after extensive hearings

and full discussion, determined the debtor's going concern value to be $2,780,000. Comparing that value with the creditor's claims which had been allowed in the total amount of about $5,400,000, the district court found the debtor to be insolvent. After this Court's last remand, the district court required further evidence as to solvency *vel non* limited to happenings subsequent to the 1962 valuation hearings. Upon that evidence, the Court commented:

> "The court required, by order entered January 5, 1965, further evidence on this subject limited to happenings subsequent to the 1962, valuation hearings. The court had found the debtor insolvent at that time, and it appears from subsequent events that the debtor is more insolvent now than it was in 1962 when earnings had reached a peak. As predicted by the trustee, the level of earnings reached that year of $524,000 did not last. They dropped to $403,000 in 1963 and to $200,000 in 1964. This was caused by several unfavorable factors the principal of which was increased competition from large steamship lines serving Puerto Rico. It appears from the evidence that these competitors in the latter part of 1962 began rate-cutting practices deliberately designed to take business from TMT. They have been successful to an extent requiring TMT to reduce its rates on automobiles and other heavy volume traffic, thus materially reducing its margin of profit on each trip. This smaller margin of profit has caused a decline in net earnings in spite of a greater volume of traffic obtained by the increase of the trailer ship fleet from three to five vessels since 1962. Increases in costs of operation have also contributed to the decline in earnings.

"The SEC and the Stockholders Committee insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee or the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable. The trustee has operated the business successfully for more than seven years and the past earnings recorded under the trusteeship furnish the most reliable basis upon which to measure future earnings for going concern value purposes in this proceeding.

"The court in 1962 found the going concern value to be $2,780,000 based upon retention of the high level of earnings during the first half of that year. It is apparent now that this value was too high and would be much lower based on any average of the earnings recorded under the trusteeship.

"Another factor which depresses the value of the debtor is the requirement that the government non-tax claims must be paid in full in cash. This will reduce the equity of the new owners of the debtor by approximately $500,000.

"It is therefore the opinion of the court that the debtor remains insolvent, and the court reaffirms its former finding of insolvency and its decision that

under the strict priority rule stockholders have no equity in the reorganized company and are entitled to no further participation in these proceedings."

Included in the approximately $5,400,000 of claims allowed against the debtor were compromises of approximately $2,000,000 in two seriously disputed claims. The persons most directly affected by those compromises were other creditors, and it is significant that not a single creditor has ever complained of either compromise. The only criticism has come from the stockholders' Protective Committee supported by the Commission. It is extremely unlikely that even a disallowance of one or both compromises would result in solvency of the debtor and thus allow the stockholders to participate in a plan of reorganization. It is, of course, conceded that compromises are "a normal part of the process of reorganization." *Case v. Los Angeles Lumber Products Co.*, 1939, 308 U.S. 106, 130; 6A Collier on Bankruptcy, 14th ed., ¶8.07, pp. 28-32.

We are not called on to decide whether the district court has accurately computed the going concern value of the debtor and the amount of the creditors' claims, but only whether its decision that the debtor is insolvent is clearly erroneous. *See Meyer v. Dolan, supra; Trinity Building Corporation Preferred Stockholders v. O'Connell*, 2 Cir. 1946, 155 F.2d 327, 329. The finding of insolvency cannot be held clearly erroneous.

It follows that the stockholders represented by the Protective Committee have no further interest in the plan of reorganization and no standing to complain. This nine-year-old litigation must at long last be brought to an end. The judgments and orders appealed from are

AFFIRMED.

[OPINIONS OF THE UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF FLORIDA]

OPINION AND ORDER APPROVING AMENDED PLAN OF REORGANIZATION

March 19, 1965 [II 260]

Status of the Proceedings

This court on February 14, 1963, entered an order confirming the Internal Plan of Reorganization. Appeals were taken by the United States of America and by a Stockholders Committee. The appeal by the government resulted in a reversal of that portion of the plan and the orders approving and confirming it which provided that the government's non-tax claims were not entitled to priority. *United States of America v. Anderson.* (5th C.C.A. 1964) 334 Fed. 2d 111. The other appeal, decided at the same time, resulted in a remand of the cause "for a determination as to the position as established in the companion case." In re *TMT Trailer Ferry, Inc.* 334 Fed. 2d 118.

Thereafter, proceedings were held before this court to consider amendments to the plan made necessary by the appellate court decision in the government appeal, to consider the feasibility of the plan when so amended, and to determine whether events subsequent to the last valuation hearings held in 1962 would have any bearing on the finding made by the court in July, 1962, that the debtor was insolvent and therefore the stockholders of the debtor corporation are not entitled to participation in the reorganized company.

The Amendments to the Plan

The trustee recommended that the material provisions of the Internal Plan of Reorganization be retained and that it be amended to meet the requirements of the appellate court decisions and to include certain other minor clarifying provisions. These proposed amendments were considered at a hearing held on January 18, 1965, after notice to parties in interest, and were given tentative approval by the court in an order entered January 21, 1965. The principal amendment provided for the payment in full in cash upon consummation of the non-tax claims of the United States, the fact amount of which is approximately $904,000. The court found this to be a material change adversely affecting the interests of creditors inasmuch as the value of these claims under the plan as originally confirmed was approximately $340,000.

The only other material change was one authorizing the reorganized company to borrow upon substantial consummation of the plan up to $1,250,000 from conventional sources at current interest rates, payable over a period of years at no more than $25,000 per month plus interest, in order to meet the cash requirements of consummating the plan including payment of all the government claims in full.

The plan as amended was forwarded to the Securities and Exchange Commission for examination and report and the Commission filed its report on March 9, 1965. It was also forwarded to the Secretary of the Treasury as required by law and to all creditors and stockholders together with a Notice of Hearing to be held on March 15, 1965, for consideration of the approval of the plan as amended.

No further amendments to the plan were suggested before or at this hearing except those of the SEC that the corporate charter be amended to provide for cumulative voting by stockholders for directors of the reorganized company and to provide for preemptive rights for stockholders in the issuance and sale of any additional capital stock by the company. While there may be merit to these suggestions, they do not appear to be material to the fairness or equitableness of the plan. They were not included in the original plan which was accepted by vote of more than the required two-thirds of the creditors, and no creditor has suggested that he desires such provisions for his benefit.

It is the purpose of the court to limit material amendments to the plan to those required by the decisions of the appellate court, and in the absence of compelling reasons for the suggested further changes, the court will not require the charter to be amended in these particulars but will leave the consideration of any such amendments to future determination by the new owners of the reorganized company.*

The only objections filed to the approval of the plan were those of the Securities and Exchange Commission and of the Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. The main points in these objections were that the plan improperly excluded stockholders from participation because of alleged lack of adequate evidence as to valuation, that stockholders in the 1962 proceedings had been improperly precluded from an op-

*Reference to the Delaware law and decisions which govern the corporate debtor indicate that the charter changes which the SEC suggest are a matter of choice by the corporate owners.

portunity to present claims based on alleged fraud and conspiracy in the issuance of stock by the debtor, and that the compromises in the plan of the Merrill-Stevens and Caplan Mortgage claims had been improperly approved by the court. Nothing however, has been presented by way of evidence or otherwise to change the opinions of the court expressed in its orders in 1962 overruling these contentions. Furthermore, it is the opinion of the court that the decisions of the appellate court sent the plan of reorganization back only for determining the feasibility of the plan in light of the preferred position of the government's non-tax claims, and that by refusing to reverse this court's rulings on the issues referred to, the appellate court has in effect affirmed this court's decisions on those issues.

The court has considered other objections raised by the Stockholders Committee and finds them to be without merit. Among these is the suggestion that investigation should be made of the creditors Florida Towing Company and George H. Salley, and of their relationships with the debtor, the trustee and other creditors. The court has been fully informed from time to time of the affiliations of these creditors and finds nothing improper in them. In fact there has never been any attempt to show that these creditors have transgressed any law or duty which affects this reorganization in any way.

Furthermore, objections of this kind come too late and the court has previously approved the participation of these creditors in the affairs of the debtor which the plan was originally approved and confirmed.

The court therefore overrules all objections of the SEC and the stockholders committee with respect to the fair-

ness and equitableness of the amended plan and the affiliations of those who may be entitled to participate in the reorganized company.

The Feasibility of the Amended Plan

The only question involved here is whether the debtor will be able upon consummation of the plan to pay the government non-tax claims in full and meet the other cash requirements involved. The record shows that with payment in full of the non-tax claims a total of approximately $1,502,000 will be required for those claims which must be paid in cash.* The trustee presented evidence showing the ability of the debtor upon reorganization under the plan to borrow as much as $1,250,000 from a commercial bank on conventional terms, as heretofore outlined. This amount, together with approximately $350,000 in cash on hand would be more than sufficient to meet all cash requirements of consummation. Evidence presented shows that the assets of the debtor and its proved earning ability will secure a loan of $1,250,000 that can be paid off within a few years without impairing its working capital. The reorganized company would have no other debt.

The SEC in its report has found that the plan is feasible and the court agrees. The Stockholders Committee has questioned the feasibility, based upon a statement in an order of the court dated September 28, 1962, that the debtor did not have sufficient cash to pay the government non-tax claims in full. That statement was made, how-

*Claims total about $5,400,000. The remainder, about $3,900,000 are to be satisfied by the issuance to such claimants, pro rata, of 1,300,000 shares of the authorized common stock of the reorganized debtor.

ever, in the absence of evidence at the time of the ability of the debtor upon reorganization to borrow sufficient money to pay such claims in full. It is readily apparent that at this time the debtor can finance the cash requirements of consummation.

The stockholders committee also urges that the bank loan commitment which the trustee presented in order to prove the debtor's ability to borrow $1,250,000 is conditioned upon management satisfactory to the bank, that this is objectionable because the trustee is a director of another affiliated bank, and that it would give the lending bank and the trustee indirectly some measure of improper control over the reorganized company. This contention is without merit because it is not improper for the trustee to seek a commitment from a bank with whom he has some connection, and the court in accordance with the provisions of the plan will see that the initial management of the reorganized company is responsible and acceptable in commercial circles. Furthermore the reorganized debtor will not be bound to borrow from the bank that made the commitment, The Florida National Bank of Jacksonville, Florida. It is the opinion of the court that when the time comes the reorganized debtor will have no trouble making such a loan from any commercial bank with resources sufficient for a loan of that size.

The Solvency of the Debtor

The court required, by order entered January 5, 1965, further evidence on this subject limited to happenings subsequent to the 1962 valuation hearings. The court had found the debtor insolvent at that time, and it appears from subsequent events that the debtor is more insolvent

now than it was in 1962 when earnings had reached a peak. As predicted by the trustee, the level of earnings reached that year of $524,000 did not last. They dropped to $403,000 in 1963 and to $200,000 in 1964. This was caused by several unfavorable factors the principal of which was increased competition from large steamship lines serving Puerto Rico. It appears from the evidence that these competitors in the latter part of 1962 began rate-cutting practices deliberately designed to take business from TMT. They have been successful to an extent requiring TMT to reduce its rates on automobiles and other heavy volume traffic, thus materially reducing its margin of profit on each trip. This smaller margin of profit has caused a decline in net earnings in spite of a greater volume of traffic obtained by the increase of the trailership fleet from three to five vessels since 1962. Increases in costs of operation have also contributed to the decline in earnings.

The SEC and the Stockholders Committee insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee or the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable. The trustee has operated the business successfully for more than seven years and the past earnings recorded under the trusteeship furnish the most reliable basis upon which to measure

future earnings for going concern value purposes in this proceeding.

The court in 1962 found the going concern value to be $2,780,000 based upon retention of the high level of earnings during the first half of that year. It is apparent now that this value was too high and would be much lower based on an yaverage of the earnings recorded under the trusteeship.

Another factor which depresses the value of the debtor is the requirement that the government non-tax claims must be paid in full in cash. This will reduce the equity of the new owners of the debtor by approximately $500,000.

It is therefore the opinion of the court that the debtor remains insolvent, and the court reaffirms its former finding of insolvency and its decision that under the strict priority rule stockholders have no equity in the reorganized company and are entitled to no further participation in these proceedings.

Necessity for Terminating These Proceedings

It will be soon eight years since these reorganization proceedings began in June 1957. The unpaid claims of more than five million dollars include trade creditors of more than four million in addition to governmental claims of nearly one million two hundred thousand. The Internal Plan of Reorganization as Amended is the product of several years of effort by the court, the Trustee and representatives of creditors to produce a fair and equitable plan that will give the unsecured creditors an opportunity to realize eventually a portion of their claims.

These proceedings have been the subject of five recorded decisions by the United States Court of Appeals for the Fifth Circuit. The last two decisions of that court, referred to above and decided in June 1964, appear to have settled all issues under the present plan of reorganization other than the question of its feasibility which this court now, with the concurrence of the Securities and Exchange Commission, has determined in favor of the plan as amended. No creditor has voiced any objection to the amended plan and it is the hope of the court that it will be accepted by them in the vote that will be taken so that TMT can be returned to private control in the near future and the long trusteeship terminated.

Objections to the plan come only from a Stockholders Committee which has never represented, by its own admission, more than a minute fraction of approximately seven thousand stockholders. The SEC has supported this committee with great zeal in an effort to obtain some equity for the stockholders, but the SEC appears to have overlooked the superior rights of creditors holding more than $5,000,000 in claims to whom they also have a duty. See *Securities and Exchange Commission v. American Trailer Rentals. Co.*, ___ U.S. ___ October Term, 1964, decided January 18, 1955. The court has given thorough consideration throughout these proceedings to the alleged equities of the stockholders, but is required on the record before it to conclude that there is no merit to the contentions made in behalf of the stockholders. Their rights in TMT must give way to the superior rights of the creditors when the debtor is clearly insolvent.

Wherefore, it is ORDERED, ADJUDGED and DECREED that:

1. The Internal Plan of Reorganization as Amended is fair and equitable and feasible, and is hereby APPROVED by the court.

2. The Summary of the Internal Plan of Reorganization as amended, attached hereto as Exhibit A, is hereby approved.

3. The Trustee shall transmit by mail to each creditor of the debtor, including debenture bond holders, and to the Securities and Exchange Commission and to the Secretary of the Treasury of the United States, a copy of each of the following:

a. This order with Exhibit A hereto.

b. The Internal Plan of Reorganization as Amended.

c. The Report and Recommendations of the Securities and Exchange Commission on the Amended Plan.

d. A form for acceptance or rejection of the Amended Plan, as approved by the Court.

4. April 7, 1965, is fixed as the day and the time within which creditors of the debtor, including debenture bond holders, may accept or reject the Amended Plan by executing and delivering to the Trustee by mail or otherwise the form provided therefor, on or before said date.

5. The Trustee shall file with the court no later than April 13, 1965, his report of acceptances and re-

jections of the Amended Plan, and shall mail a copy thereof to those parties entitled to notices of proceedings herein.

6. A hearing will be held before the court in the Post Office Building, Miami, Florida, on Monday, April 19, 1965, at 3:00 o'clock P.M. for the following purposes:

a. To consider the Trustee's Report of Acceptances and Rejections of the Amended Plan, and any objections thereto.

b. To consider the confirmation of the Amended Plan if the same is accepted by the required number of creditors, and such objections as may be made thereto.

c. To consider appropriate action under Section 236 of the Bankruptcy Act if the Amended Plan is not accepted by the required number of creditors or if confirmation thereof is refused.

d. To adjourn said hearing from time to time without further notice if the court determines that such action is desirable.

7. The court retains jurisdiction of this cause for further proceedings herein.

DONE and ORDERED at Miami, Dade County, Florida, this 18th day of March 1965.

s/ Emett C. Choate
United States District Judge

ORDER DISCHARGING STOCKHOLDERS COMMITTEE

March 19, 1965 [II 387]

The Protective Committee for Independent Stockholders of TMT Trailer Ferry Inc., was authorized by order of this court to represent the interests of stockholders of the debtor by order dated September 16, 1957. This committee is composed of Raymond M. Dukaty, Nathan D. Lobell and Irwin S. Mason.

It has subsequently been determined in proceedings held from time to time that the debtor is insolvent. Findings of insolvency have been entered by this court in orders dated February 24, 1959 and July 9, 1962, and March 18, 1965. An appeal by the Stockholders' Committee from the insolvency order of July 9, 1962, resulted in a decision by the appellate court that it was unnecessary to determine the issues raised in behalf of stockholders, and thus the insolvency order was allowed to stand with all rights of stockholders eliminated from further consideration. See *The Protective Committee, etc. v. Anderson*, 334 F.2d 118 (5th CCA-1964).

It is apparent that no further services are required of the Stockholders' Committee since the court has approved and confirmed the Internal Plan of Reorganization as Amended, which like its predecessors eliminates all equity of stockholders.

Recent efforts of the Stockholders' Committee to litigate

issues which have been determined by this court adversely to the Committee's contentions have been stopped by orders of this court. ORDER DENYING MOTION FOR PRODUCTION OF DOCUMENTS, dated January 21, 1965, and ORDER SUSTAINING OBJECTIONS TO REQUEST FOR ADMISSIONS, dated May 14, 1965, were entered as a result of the Committee seeking information from the United States government pertaining to certain claims that have been allowed and liquidated in the plan of reorganization. These efforts of the Committee to litigate matters which are not in issue before the court are not in the best interests of the debtor.

No useful purpose to either the stockholders or the debtor will be served by continuing to recognize the Committee as a party to these proceedings.

WHEREFORE, it is ORDERED, ADJUDGED and DECREED that Raymond M. Dukaty, Nathan D. Lobell and Irwin S. Mason as PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY INC. be and they are hereby discharged as representatives of stockholders as a class in these proceedings; provided however that said committee may prosecute such appeals as they have heretofore taken and are pending from the recent orders of this court.

DONE and ORDERED at Miami, Dade County, Florida, this 18th day of May, 1965.

s/ Emett C. Choate
United States District Judge

ORDER IN AID OF CONSUMMATING PLAN OF REORGANIZATION

May 25, 1965 [II 389]

This cause was heard after due notice to parties in interest on the Trustee's PETITION FOR CONSUMMATION OF PLAN OF REORGANIZATION. The only objections to consummating the Plan are those of the Protective Committee for Independent Stockholders of TMT Trailer Ferry Inc., and of the Securities and Exchange Commission, the Stockholders' Committee having filed Notice of Appeal from the order entered herein dated April 22, 1965 confirming the Plan of Reorganization.

The SEC has filed a motion for an order staying the Trustee and the reorganized company from issuing any stock incident to consummation of the reorganization plan pending ultimate determination of all issues in the appeals arising out of this proceeding, on the ground that consummation of the Plan may cause irreparable harm to the debtor and the investing public in the event of reversal of the Order of Confirmation. It is asserted by the SEC that the appeals referred to, all taken by the Stockholders' Committee, will raise certain issues with respect to the Plan of Reorganization that were considered by the appellate court in the former appeal by the Committee which was decided by the Fifth Circuit on June 8, 1964. See *Protective Committee etc. v. Anderson*, 334 F.2d 118.

The main issues which the Stockholders' Committee and the SEC continue to raise concern the solvency of the Debtor and the possible fraud claims by stockholders. The record shows that evidence has been presented on the

solvency at numerous times during these proceedings and this Court has made findings of insolvency in orders dated February 24, 1959, and July 9, 1962, and March 18, 1965.

It is also asserted by these parties that the plan of reorganization should make provision for encouraging stockholders to file claims based upon alleged fraud in the issuance by the debtor of its common stock. The Court has always been available to adjudicate any valid claims of fraud by stockholders, but none were filed except those filed by the Stockholders' Committee purporting to act on behalf of defrauded stockholders generally. The contentions of the Stockholders' Committee and of the SEC with respect to the existence of such claims were disposed of in this Court's OPINION AND ORDER APPROVING PLANS OF REORGANIZATION dated July 9, 1962, and again in the OPINION AND ORDER APPROVING AMENDED PLAN OF REORGANIZATION of March 18, 1965.

Other issues sought to be re-litigated at this late date in these proceedings concern the propriety of provisions in the plan of reorganization for settlement of the Caplan preferred ship mortgage claim and of the maritime lien claims of Merrill-Stevens. These settlements were approved by the Court in the July 9, 1962, order approving the plans of reorganization, and the settlements as well as other elements of the present plan have been accepted twice by vote of the creditors, first in 1962 and recently in 1965. The creditors are the only ones concerned in these settlements because, as this Court has previously found, if these two claims were disallowed in toto, the debtor would still be insolvent.

What is most significant with respect to the raising of these issues again, nearly three years after this Court had first disposed of them, is that they were taken to the Fifth Circuit Court of Appeals in the case cited and that court refused to disturb the decisions of this Court. The appellate court said it was unnecessary to determine those issues and sent the proceeding back to this Court solely for a determination as to the feasibility of the plan in view of the decision rendered at the same time holding that the non tax claims of the United States government must be afforded priority.* This Court has found the plan feasible after its amendment to provide for the payment in full of all government claims, and the Securities and Exchange Commission has likewise found the amended plan feasible in the report thereon that it has filed. It is therefore the opinion of the Court that there will be no merit whatever to appeals taken which raise only issues that the appellate court has had before it and found unnecessary to determine. Under these circumstances there should be no further delay in consummating the Plan of Reorganization and the motion of the SEC for a stay will be denied.

The objections of the Stockholders' Committee to the consummation of the plan are the same as those previously asserted and overruled with respect to the approval and confirmation of the plan. They are substantially the same as those of the SEC; that is, their objections to the plan are the same as those made to the original Internal Plan of Reorganization and outlined above, and which were the subject of the former appeal. They are therefore without merit.

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*See *United States* v. *Anderson* 334 F.2d 111

The Trustee has requested authority to proceed with certain essential actions to be taken in consummating the plan. The certificate of incorporation of the debtor should be amended as proposed by the Trustee in order to comply with the requirements of the plan. No objections have been made to the taking of that action. It has been recommended that the Court reapprove the persons to be the directors of the reorganized company. The following have been heretofore approved as directors by order entered herein dated May 16, 1963: —

C. Gordon Anderson of Miami, Florida
B. E. Thouvenelle of Miami, Florida
Gardner T. Gillette of Jacksonville, Florida
James C. Merrill, Jr. of Jacksonville, Florida
W. T. Coppedge, Jr. of Jacksonville, Florida
Shelby P. Langston of Miami, Florida
Rafael Martinez-Alvarez of San Juan, Puerto Rico

The identity, qualifications and affiliations of the above named persons have been fully disclosed; no objections have been voiced to their appointment; their appointment as initial directors of the reorganized company is equitable, compatible with the interests of the creditors and all other parties concerned and is consistent with public policy.

No objection has been expressed to the approval of the reorganized company borrowing up to $1,250,000 under the provisions of the plan to raise the necessary cash required to consummate the plan and the Trustee has presented evidence showing that such a loan is available from the Florida National Bank and Trust Company of Jacksonville, Florida.

The Court finds that the best interests of the debtor require the prompt consummation of the Plan of Reorganization and termination of these proceedings which are in their eighth year.

The SEC has announced an intention to seek a stay order in the appellate court if this court denies the SEC motion for a stay; therefore this order will not become effective for *15* days in order to give parties an opportunity to perfect any emergency appellate action desired.

WHEREFORE it is ORDERED, ADJUDGED and DECREED as follows:

1. The objections of the Stockholders' Committee to the consummation of the plan are OVERRULED.

2. The petition of the Securities and Exchange Commission for a stay of the issuance of any new common stock is hereby DENIED.

3. The Trustee is authorized and directed to proceed with the consummation of the plan in the particulars set forth in his Petition.

4. The seven persons named above in this order are hereby approved as the initial Board of Directors of the reorganized debtor and they are authorized and directed to meet for the purpose of organizing and taking such actions as are required to consummate the plan.

5. This order shall become effective *15* days from the date hereof.

6. The Court retains jurisdiction for the purpose of supervising the consummation of the Plan of Reorganization and carrying on the trusteeship for the purposes stated in the Plan.

DONE AND ORDERED at Miami, Dade County, Florida, this 24th day of May, 1965.

s/ Emett C. Choate
Senior United States District Judge

BANKRUPTCY ACT PROVISIONS INVOLVED

Sec. 167. The trustee upon his appointment and qualification —

(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

(4) may, subject to the approval of the judge, employ such person or persons as the judge may deem necessary for the purpose of assisting the trustee in performing the duties imposed upon him under this chapter;

(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named.

Sec. 221. The judge shall confirm a plan if satisfied that —

(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been jully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy.

Office-Supreme Court, U.S.
FILED
JAN 30 1967
JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,

Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

William P. Simmons, Jr.
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida 33131

Attorney for Respondent

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No.

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,

Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

TMT Trailer Ferry, Inc. has been involved in reorganization proceedings since June, 1957. It was insolvent at the time and in spite of substantial earnings under the management of its business by an efficient trustee it has remained insolvent. For this reason its stockholders have been excluded from participation in all of the several

plans of reorganization that have been considered from time to time.

The tally of claims against the debtor in round figures is as follows: (III 224)[1]

U. S. government tax and non-tax claims required to be paid in cash	$1,097,000
Tax claims of other governments	84,000
Preferred ship mortgage covering all five vessels remaining for use by the debtor (Referred to as the Caplan mortgage or the Sheaffer-Spitzer mortgage)	330,000
Lien claims against vessels and equipment	129,000
Claims of general or unsecured creditors	3,796,000
TOTAL	$ 5,436,000

The value of the assets of the debtor was far less than the total of these claims. The book value in June 1962 at the conclusion of a series of valuation hearings was $1,887,185.77 (II 387.1) and the district court found the actual value at the time to be $1,978,481.73. (II 387.2) The success of the trustee in operating the debtor's business resulted in its having a going concern value in excess of the appraised value of its assets, and the district court found this going concern value to be $2,780,000. (II 387.5-387.6) Earnings have declined materially since this finding. They were up to $524,000 in 1962 when the findings were made, but dropped to $403,000 in 1963 and to

[1]References to the records before the court will be the same as those used in the Petition for Writ of Certiorari: III refers to the record in the most recent appeal to the Fifth Circuit, Case No. 22,652. II refers to the record in Fifth Circuit Case No. 19,996. I refers to the record in Fifth Circuit Case No. 18,475.

$200,000 in 1964. (III 77) They have declined even further since 1964.

The insolvency of the debtor is actually greater than is indicated by the above figures. Before stockholders can participate, the creditors must be paid not only the face amounts of their claims as listed above, but also post-bankruptcy interest in full. *In re Inland Gas Corp.* (6th Cir. 1957) 241 F.2d 374 (cert. den. 335 U.S. 838, 2 L.Ed. 2d 50); *Spitzer v. Stichman* (2d Cir. 1960) 278 F.2d 402. Such interest in this case would amount to several million dollars since the proceedings are now in their tenth year.

The strict priority rule prescribed by this court requires *full compensatory treatment* for creditors before stockholders have any equity in the property of a reorganization debtor. *Consolidated Rock Products Co. v. DuBois* (1941) 312 U.S. 512, 85 L.Ed. 982.

These figures illustrating the hopeless insolvency of this debtor are cited because it has been a major contention of the Petitioner (sometimes herein referred to as the Stockholders Committee) throughout the proceedings and now before this court that the debtor can somehow be shown to be solvent. This is to be done by refusing to compromise or settle any claims but instead litigating every possible objection to them, and by suing every person connected with the former management who might be held financially responsible for some part of the debtor's losses.

The problems involved in developing a plan of reorganization for this debtor were inherently difficult. Money was not available to pay in cash as required by law the

large amount of U. S. government claims. Claims secured by mortgages and liens had to be provided for before common creditors could be considered. There was no capital available, except out of the trustee's earnings, for needed replacement of the vessels which were old Navy LSTs declared surplus after World War II.

The plan of reorganization finally evolved (III 247-259) was an "internal" one by which the company is turned over to its common creditors who exchange their claims, pro rata, for all of the new common stock. Governmental preferred creditors are paid in full in cash, and creditors holding liens are paid over a period of time. The plan provides for settlements of two large controversial claims, those of the Caplan mortgage and Merrill-Stevens Drydock and Repair Company. The plan was accepted by an almost unanimous favorable vote of the creditors. (III 316)

The plan was confirmed by the district court in April 1965 (III 328-331) without objection from any creditor. Final consummation of the plan has been delayed pending the appeal by Petitioner to the Circuit Court of Appeals and the outcome of the pending Petition in this court.

Petitioner's Statement of the Case contains many misleading and inaccurate statements implying improper conduct by the trustee. For example on page 9 of the Petition, the statement is made that "the trustee's second plan gave control of the company principally to Merrill-Stevens" . . . The truth is that the initial internal plan, to which the statement refers, was proposed not by the trustee but by a court-appointed committee of attorneys

representing unsecured creditors as a class (II 41-42), and it gave control to *all* such creditors, not to Merrill-Stevens who was only the largest of such creditors.

The statement is also made that the trustee was to have a long-term contract with the reorganized company and assurance of substantial stock options. While such provisions for the trustee were suggested at one time by the creditors, there have never been any such provisions in any of the plans approved by the court. The entire issue with respect to the propriety of the trustee being retained as president and manager of the reorganized debtor was argued and decided in the prior appeal. (Fifth Circuit Case No. 19,996) See *In re TMT Trailer Ferry, Inc.* (1964) 334 F.2d 118. The issue was finalized by that decision and the current plan of reorganization contains the same authorization for the retention of the trustee's management as was approved in the cited case.

ARGUMENT

We will argue the questions presented on pages 2 and 3 of the Petition and in the order listed but will restate them more accurately.

1. All material matters involved in the preparation, approval, acceptance and confirmation of the plan of reorganization were fully heard and considered by the district court and argued and affirmed by the appellate court.

It is apparent from the Petition herein that Petitioner seeks a further review of matters that have been very

thoroughly considered by the district court and whose decisions have been affirmed in two opinions by the appellate court.[2] It is significant that no attack is made on the *procedure* prescribed in the Bankruptcy Act for the preparation, consideration, approval, acceptance and confirmation of a plan of reorganization.

There is no basis in the record for the charge that hearings were not held "on substantial issues going to the essential fairness of the plan." The internal plan of reorganization was the subject of two series of hearings in the district court. The first were in 1962 when hearings were held on April 24-25 (II 42-230), and on May 2 (II 259-300), and on June 19 (II 310.52-356) at which extensive evidence was received with respect to the value of the debtor's assets and business and the fairness and feasibility of the plan of reorganization. Later, when amendments to the plan were being considered, hearings were held on November 4, 1964, (III 21-66), on January 18 & 19, 1965 (III 83-189) and on March 15, 1965. (III 284-308) These hearings resulted in appropriate orders by the district judge passing on the matters sought to be further reviewed here. The findings were based upon *substantial evidence* and should not be disturbed unless *clearly erroneous*. *Spitzer* v. *Stichman*, 278 F.2d 402 (2d Cir. 1960).

It is not specified in the Petition for Writ of Certiorari precisely where and how the District Court erred in making its ultimate findings with respect to the fairness, equitableness and feasibility of the plan of reorganization that was finally evolved after years of effort and

[2]In re TMT Trailer Ferry, Inc. (1964) 334 F.2d 118; Protective Committee etc. v. Anderson (1966) 364 F.2d 936.

controversy. The petition relies on vague charges of conspiracy by creditors and connivance by the trustee in seeking to convince this court that neither of the two lower courts has given the case proper consideration. We do not consider it necessary in this brief to burden the court with a review of all the evidence in this volumnious record which supports the decisions of the trial court and their affirmance by the appellate court.

2. There is nothing in the record to sustain the charges that the trustee is guilty of improper actions that would disqualify him to act as trustee or to become president of the reorganized debtor.

The main thrust of the Petition is an attack upon the motives and integrity of the trustee with the implication that he is personally at fault regarding the failure of the plan of reorganization to make some provision for stockholder participation. It will suffice to answer these charges by pointing out that every action of the trustee has been the subject of thorough consideration and approval by the district court, and that his actions as well as the orders approving them have been reviewed and affirmed twice by the Circuit Court of Appeals.

It is significant that nowhere in the entire proceedings is there any suggestion or motion that the trustee should be removed for improper conduct or affiliations. The trustee was appointed in November 1957 and his actions have been the subject of judicial scrutiny and approval for more than nine years. The Petition herein goes so far as to charge him with protecting defrauding creditors. (P. 21 of Petition) This kind of scandalous

charge is in reality one against the lower courts for it is they who have determined the rights of creditors and not the trustee.

The same can be said of the charge that the trustee is disqualified from being affiliated with the management of the reorganized debtor. All of the trustee's actions in dealing with the creditors who are to own and control TMT upon consummation of the plan were submitted to the district court and approved. It was the creditors who wanted the trustee's services retained because he had been successful in running the business. The only provision in the plan of reorganization on the subject reads:

> "It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the court."

P. 4a, Appendix to the Petiiton.

The Court of Appeals properly upheld this provision and refused to disqualify the trustee.

> 3. All charges of fraud against major creditors were properly investigated in the district court proceedings, and there is no basis for the contention that compromises of major claims against the debtor were improperly approved by the district court.

The charges of fraud against the holders of the Cap-

lan (Shaffer-Spitzer) preferred ship mortgage were the subject of a long and thorough investigation by the trustee whose report to the court is in the record. (I 255-295)

As to the charges filed against the holders of the Merrill-Stevens claim and the objections thereto, the record includes a lengthy report by the trustee explaining the extent of his investigation and why he recommended against litigating the issues. (II 22-26) A hearing was held on the trustee's recommendations (II 35-40) and thereafter negotiations resulted in the unsecured creditors' committee (*not* the trustee) making the initial proposal for an internal plan of reorganization that included the compromise settlement of the Merrill-Stevens claim. (II 41-42) The district court, as pointed out in our Statement of the Case, held many hearings on the plan and its various amendments and expressly approved the Merrill-Stevens compromise. (II 372-373, III 263-264)

Likewise, the trustee eventually on advise of counsel recommended against suing the holders of the Caplan mortgage and proposed the settlement of that claim which is included in the plan of reorganization. (III 250-251)

The Petitioner here, representing the stockholders, has no valid standing to object to these compromises because if the two claims which totaled $1,958,284.40 were *disallowed in toto* the debtor would remain insolvent and there would still be no equity for stockholders. The district court so found in its valuation order. (II 387.6) The creditors are the real parties in interest and it is for their benefit that the reorganization be concluded and not delayed by protracted and expensive litigation.

The approval of a compromise is an exercise of judicial discretion which should not be disturbed unless the court acted arbitrarily or clearly abused its discretion. *Daniel Hamm Drayage Co.* v. *Willson* 178 F.2d 633, 635 (8th Cir. 1949); *Fernow* v. *Gubser*, 136 F.2d 971 (10th Cir. 1943); *In re Prudence Co., Inc.*, 98 F.2d 559 (2d Cir. 1938) cert. den., sub. nom. *Stein* v. *McGrath*, 306 U.S. 636, 83 L.Ed. 1037.

4. The debtor was found to be insolvent, and stockholders thereby excluded from participation, as a result of competent and substantial valuation evidence clearly indicating insolvency.

We have outlined in our Statement of the Case the material facts indicating the insolvency of the debtor.

It will suffice to point out that Petitioner contends the findings of insolvency by the district court are based upon an alleged "inadequate" record of the estimated future earnings of the debtor in determining its going concern value. The inadequacy is asserted to be the failure to anticipate greatly increased earnings under private management. Our position and that of the district court is that it is not proper to speculate on what improvements the future private management of the company might make in the operation of the business, and that is not possible to estimate what effect they might have on future earnings. The only reliable and proper way to determine the going concern value of a successfully operated business such as TMT is to base such value on the record of its present and past earnings, as was done in this case.

This position was fully sustained by the Fifth Circuit Court of Appeals. See pages 10a-13a of the Appendix to the Petition.

5. The district court and the appellate court properly rejected the contention that stockholders are entitled to be treated as creditors of the debtor.

The Supreme Court of Michigan has aptly stated:

> "When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another and, to assume the role of a creditor, is very strong, and all attempts of that kind should be viewed with suspicion."
>
> *Thompson* v. *American State Bank of Detroit*, 239 N.W. 373, 374. (1931)

As stated in the Petition there were more than 7,000 stockholders of the debtor. It is significant that only one of them filed a claim seeking treatment as a creditor, Irma S. Mason, attorney wife of Malcolm S. Mason who in the district court and in the appellate court was one of the attorneys representing the Petitioner.

The Mason claim (II 358-363) sought to recover from the debtor what had been paid *on the open market* for TMT stock more than nine months before the reorganization proceedings began. *Rescission of the purchase* is sought and the *debtor* held liable for the cost of the stock because of an alleged *conspiracy* between the debtor and

its financial advisors which resulted in the market being flooded with "illegally issued stock" of which the Mason stock was "probably" a part.

The claim was not timely filed and the district court held it to be without merit for that reason and also because the facts relied on failed to show that stockholders either as a class or individually could assert claims as creditors. (Page 9a of Appendix to Petition)

It can not be properly contended here that the decisions of the district court and of the appellate court in refusing to consider stockholder rescission claims were clearly erroneous.

CONCLUSION

Petitioner seeks a complete review by this court of all the facts and circumstances surrounding this debtor which were material to the forming of the plan of reorganization. The Petition does not indicate any special and important reasons why this court should revalue the equities of the plan in view of the thorough consideration given them by the district court and the circuit court of appeals.

It is important that these proceedings be concluded without further delay. It will soon be ten years since they began. There is no assurance that a re-trial of any of the issues would result in any benefit to the stockholders, while the creditors are being harmed by any more postponement of an opportunity to recover some of their losses.

We respectfully urge that the Petition for Writ of Certiorari be denied.

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Dated: January 26, 1967.

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JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. ~~952~~ 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner

vs.

C. GORDON ANDERSON, TRUSTEE

Respondent

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITIONER'S REPLY BRIEF

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner

vs.

C. GORDON ANDERSON, TRUSTEE

Respondent

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITIONER'S REPLY BRIEF

Three features of the respondent trustee's brief in opposition require comment:

1. At no point does the trustee address himself directly to our claim, supported by detailed

citations of cases in conflict, that this case merits certiorari review.

2. Instead, the trustee raises fact questions appropriate only to remand after rectification of the procedural errors that we say kept essential facts out of the record.

3. At no point does the trustee so much as mention the Securities and Exchange Commission, much less take account of the circumstance that on every major issue in this long proceeding, both on law and on facts, the SEC has agreed with us that the course of the proceedings below has violated the basic protections of Chapter X.

The first two are standard distraction tactics for any respondent in certiorari. The third is peculiar to Chapter X and to the advisory role of the SEC. This responsible public agency, "about the only wholly disinterested party in the proceeding", *Finn v. Childs Co.*, 181 F2d 431, 438 (CA2, 1950), an active participant from the beginning, after close familiarity with the entire proceedings and careful study and report, rejected each of the assertions of fact and the applicability of each of the contentions of law on which respondent trustee rests (references collected Pet. 7, 8, 9, 10, 12, 13, 15, 16, 17, 18, 29, 31).

A. *The trustee's treatment of the questions of law:*— The trustee sidesteps every question of law that the petition presents for certiorari review. He cites no law at all on our contention that the decision below is in conflict with the specific cases we cited from other circuits and

from this Court as to the error of retrospective valuation (Pet. 33), the error of summary findings without hearing on laches (Pet. 32), the error of failure to investigate responsible fraud charges against dominant creditors (Pet. 30) and the error of treating heavy creditor approval (Pet. 29) or assumed lack of standing of the complaining stockholders (Pet. 27) as precluding review of the fairness of the plan.

To our contention that the decision below is in conflict with a specifically cited decision of this Court as to the creditor position of defrauded stockholders (Pet. 31) he replies only that there is Michigan dictum that supports him (Br 11). To our contention that the acceptance of compromises here is procedurally invalid under specific decisions of two other circuits because of inadequate record disclosure quite apart from the merits, the trustee replies only with the familiar general law that compromises are discretionary (Br 10). But the precise question is whether compromises whose basis is not made manifest on the record are saved as discretionary, and the decisions we cited say no (Pet. 32).

Likewise where our petition addresses itself to the exercise of this Court's Rule 19(b) supervisory power over the trustee as a court officer, simply because the courts below have demonstrated a lack of alertness and sensitivity to the imperative need for making this officer perform his statutory duties and for enforcing the procedural protections of Chapter X (Pet. 25-6, 34), the trustee replies only that the courts below approved what he did (Br 6, 7, 9). This begs the question, which is whether they should have so approved.

Thirty years ago the SEC, in the monumental report that led to the procedural reforms embodied in Chapter X, pointed out how easy it is for those who dominate a bad reorganization to make it look good enough for a trusting court to approve:

> "Outwardly reorganizations may appear to be expeditious, economical, fair, and honest. Often, however, those characteristics will only be illusions. Reorganizers will merely have dressed the procedure in familiar and respectable garb", Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part I, p5 (1937).

The unabashed trustee makes the bland statement that the Petition makes no attack on the "*procedure* described in the Bankruptcy Act for the preparation, consideration, approval, acceptance and confirmation of a plan of reorganization" (Br 6, his emph.). But most of the complaints that the Petition brings to this Court are that we were indeed deprived throughout of the *procedural* protections of Ch X — e.g., failure to require record disclosure under General Orders 33 and 52(2) of the basis of compromises (Pet. 16, 32), failure to require the trustee to investigate under §167 (Pet. 30), failure to lend the court's discovery process to let the Committee bring into the record what its own investigation had disclosed (Pet. 12), ultimately discharging the Committee for stubborn disobedience in presuming to raise these contentions that the District Court had erroneously deemed foreclosed as a matter of the law of the case (Pet. 12).

The trustee makes the standard contention that the District Court's findings were based upon substantial evidence and should not be disturbed unless clearly erroneous (Br 6). Of course. But substantial evidence in the record is not enough when as here erroneous procedures prevented evidence to the contrary from coming into the record.

Moreover findings in Chapter X proceedings do not come to this Court clothed with the heavy presumption of regularity accorded most trial court action. In the Chapter X field, when the SEC exercises as here its statutory option to participate in a reorganization by way of appearance, advisory reports, and joining in appeals,[1] the shoe may be on the other foot. As the Second Circuit put it in *Conway v. Silesian Amer. Corp.*, 186 F2d 201, at 202-203 (CA2, 1950), where the presumption of trial court regularity was unsuccessfully urged in support of approval of a compromise plan the SEC had found — as here — unfair:

> "But we are not justified in thus oversimplying this difficult problem, so much more one of forecasting the future than of restating the past. Naturally careful consideration is due the conclusion of the able district judge who has had this lengthy reorganization so long under his control. At the same time we cannot overlook the fact that the governmental agency charged with substantial responsibility in the premises, the Securities and Exchange Commission, had made an extensive investigation resulting in a detailed and helpful report with a reasonable conclusion which the trial judge has rather summarily re-

[1]The Commission, however, "may not appeal or file any petition for appeal", Bankruptcy Act, §208 (11 USC §608).

> jected. If the considered findings of this agency with so much better facilities for investigation than those possessed by either this or the trial court, are to have any force beyond their initial impact below, then we think that they will largely offset the usual presumption accorded a decision of first instance. Otherwise much of the statutory purpose in creating an expert body for the consideration of technical problems will be set at naught. Compare 6 Collier on Bankruptcy ¶7.30, 14th Ed. 1947. We have elsewhere stressed the importance of due regard for Commission findings, Finn v. Childs Company, 2 Cir., 181 F2d 431, 438; and we are clear that here, too we must give weight to the detailed evaluation of the facts made by this reliable and experienced public agency and to the conclusion reached, even though this was not accepted by the trial judge".

See also on the counterbalancing effect of the SEC views, *Ashbach v. Kirtley*, 289 F2d 159 (CA 8, 1961); *Scribner and Miller v. Conway*, 238 F2d 905 at 907 (CA2, 1958); *In re Solar Mfg. Corp.*, 215 F2d 555 at 562 (CA3, 1954); *Chicago & West Towns Rys. v. Friedman*, 230 F2d 364 (CA7, 1956).

B. *The trustee's injection of questions of fact:* — Within the limits of time and paper appropriate to reply brief at the petition stage we may shortly tick off a couple of major points of fact that the respondent's brief misleadingly presents.

i. *The lack of Merrill-Stevens fraud investigation:* — Responding to our complaint of the District Court's failure

to hear our fraud charges against the Merrill-Stevens claim, the trustee would have the Court believe that we misstated the facts when we said (Pet. 8-9, 13, 16) that there had been neither investigation nor hearing on these charges. But the very record passages that the trustee cites show that the investigation and hearing he mentions took place before the end of 1961, with leave to the Committee to pursue the matter further (II, 37). It was only thereafter, in February 1962, that the Committee submitted its 40 pages of detailed allegations on subjects new to the record, such as Merrill-Stevens conspiracy with the old management and with the Shaffer-Spitzer-Caplan principals in market-rigging; and it was these allegations that we complain were ignored (record citations collected, Pet. 8-9). And likewise investigations made by the trustee in 1961 will not excuse refusal to look at evidence of the aspects of the fraud we discovered only in 1965 by way of incriminating documents the trustee said he had never seen (record citations collected, Pet. 12). SEC concurrence in our basic position on these points is noted at Pet. 9, 12-13.

ii. *The assurances of the trustee's tenure:* — The trustee attempts to disown his conflict of interest in advancing a contested plan that contemplated keeping him on in postreorganization management. He points to the petty fact that the final text of the reorganization plan contained no explicit provision for a long-term contract and substantial stock options (Br. 5, 8), although this was initially explicit and later replaced by transparent euphemism (ib.; Pet. 14, 25). He also argues that a creditors' committee rather than himself was the titular author of the original plan. In view of the concentration of general creditors' claims into the hands of the tugboat operator

and the insurance broker who are the trustee's patronage beneficiaries and share control with him under the plan (Pet. 9), it is hardly material whether it was the trustee who was catspaw for the creditors' committee or they for him. At that, the creditors' committee plan, bearing a management contract rider, was formally approved by the trustee (II, 695, 707, 710).

The essential point is that the Court of Appeals in remanding on the appeal from the 1962 plan had rejected the SEC's position (Advisory Report quoted Pet. 13 n) that inherent self-interest bars a trustee from accepting postreorganization management status under a contested plan; but that court had ruled that "a trustee would not be disinterested within the meaning of 11 U.S.C.A. §538 if the proponents of a plan assured him of emoluments and security ***", 334 F2d 118, 119-120; Pet. App. 4a-5a; Cf. 364 F2d 936, Pet.App. 8a. On this clearly open issue of "emoluments and security", therefore, we tendered proof and sought a hearing, which the District Court denied on the incorrect claim of law of the case; and though the Court of Appeals recognized that this ruling was wrong, it let the denial of hearing stand without remedy (Pet. 13-14). It was and is our submission that a trustee cannot be deemed independent when inquiry into his independence has been so suppressed.

Moreover we have noted that the broad form of the issue whether the trustee should be prophylactically barred even without proof of "emoluments and security" is still open if certiorari is granted (Pet. 14 n). Whether in the broad or the narrow form, without or with such proof, the question whether a trustee may perpetuate himself in postreorganization management is one of basic importance

in the administration of the statute, never yet resolved and here presented on a record adequate for provident review.

iii. *The earnings record after the plan:* — The trustee's brief regards it as a triumphant confirmation of the wisdom of the District Court in keeping valuation low by refusal to recognize already visible trends of the company's postreorganization future, that the net profits reported by the trustee dropped after a rise (Br 2-3). The record shows that notwithstanding an unanticipated rate war (III, 127) revenues continued after the hearing to grow just as the Committee's expert witness had predicted they would (II, 249; III, 231-2), but that cost increases ate them up.

These cost increases are not what they appear to be, however. They are the sum of a) bookkeeping manipulations established by the SEC and admitted by the trustee's auditors (II, 921-3; III, 283);[2] b) padding the costs by reorganization expense which the trustee has refused to disentangle from operating expense, a substantial factor certain in fact but uncertain in amount (II, 1077-8; III, 183);[3] c) milking the profits in favor of the trustee's patronage beneficiaries, another substantial factor certain in fact but uncertain in amount (II, 950-54; III, 90);[4] and d) per-voyage cost increases attributable to the reorganization itself.

These per-voyage cost increases arise solely from the

[2]At least 5 figures annually (III, 283).

[3]Estimated at 6 figures annually (II, 1077-8).

[4]Estimated in 6 figures annually, id. The Court will note that a 6 figure distortion of the annual profit rate represents a 7-figure distortion of the valuation. Either of the latter two alone could make the difference between solvency and insolvency.

fact that the reorganization was protracted. On loss of the old company's self-propelled vessels through foreclosure, the trustee continued a makeshift operation with concededly obsolete and expensive LSTs. He had to increase his fleet of them to 5, from the 3 with which he was making his 1962 profits (II, 225; III, 152), in order to serve the constantly increasing traffic tendered him, for under reorganization conditions he could not (or said he could not) finance the more modern vessels we had urged him to buy (II, 1079-82) and which he had already programmed in detail to replace the LSTs—after reorganization (III, 126, 138, 139, 148, 153-4). Thus it is the continuance of the reorganization that has itself aggravated the inefficient high cost operating conditions of the reorganization period, and has prevented achievement of the efficient postreorganization operating conditions which the trustee has been able to project with business-like detail for all purposes except hearings on valuation (cf. SEC Report, quoted Pet. 18). Only by ignoring this can the District Court's valuation technique, improper as a matter of law (citations collected, Pet. 33) be conceived to have been confirmed by the facts.

We begrudge having to enter at all on these factual questions where we raised only questions of law, for an orderly presentation would defer the facts to the remand. The very pursuit of multiple fact issues beclouds the few important questions of Chapter X administration we sought to tender for review. Yet were we to let the trustee's fact contentions pass unchallenged we would risk a tacit admission of having attempted to mislead the Court by shrill clamor about nothing. It is indeed because the issues of a reorganization — and here one so bungled that

two out of three plans approved so far have had to be vacated — tend to be complicated by an accretion of factual matters that are not easy to review on the merits at any appellate level, that rigorous compliance with the procedures commanded by Chapter X becomes so necessary.

C. *The position of the SEC:* — Because of the surprising fact already mentioned, that the respondent trustee has chosen to shrug off, without so much as mention of the name of the agency, the record that the SEC has supported us throughout and in cited detail, we summarize that support in its broad outline by now adopting and setting out verbatim the SEC's index of the 64-page brief it filed before the Court of Appeals, on our appeal from the third (1965) plan directly involved in the present petition for certiorari.

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Respectfully submitted,

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February 8, 1967

SUPREME COURT, U.S.
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No. 37

In the Supreme Court of the United States

OCTOBER TERM, 1967

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

This memorandum is submitted pursuant to the Court's order of February 13, 1967, inviting the Solicitor General to express the views of the United States in this case.

STATEMENT

This case involves the reorganization under Chapter X of the Bankruptcy Act (11 U.S.C. 501, *et seq.*) of TMT Trailer Ferry, Inc. ("the debtor"). The Securities and Exchange Commission participated as a party in the reorganization proceeding pursuant to

Section 208 of that Act,[1] and for the most part took the same position in the courts below as the petitioner takes here.

1. THE HISTORY OF THE PROCEEDINGS

The debtor, organized in 1954, is engaged in the business of transporting loaded truck trailers and other freight on sea-going vessels between Florida and Puerto Rico. Between 1954 and 1957, it issued more than 4,000,000 shares of its common stock at prices ranging from $1 to $2.50 per share. Almost one-half of these shares were acquired by persons who dominated and controlled the debtor, and who resold the stock to public investors, for up to $4 a share. The reorganization proceeding was initiated in 1957; at that time more than 7,000 public investors owned stock of the debtor (II 580, 584, 609).[2] These stockholders have been excluded from participation in the reorganized corporation on the grounds (1) that the debtor was insolvent[3] and (2) that their claims against the debtor based upon violations of the federal

[1] In Title 11 of the United States Code the numbering of the sections of the Bankruptcy Act comprising Chapter X is higher by 400 than in the Act itself, *i.e.*, Section 208 of that Act is Section 608 of Title 11. We shall use the Bankruptcy Act rather than the Code section numbers.

[2] We shall use the same form of record references that the petitioner uses, *i.e.*, the records in the three appeals to the court of appeals will be cited as "I", "II" and "III", respectively. See Pet., n. 1, p. 2.

[3] In 1962 the district court determined that the going-concern value of the debtor was $2,780,000, as against the claims allowed of approximately $5,400,000 (II 387, 387.6). In 1965 the court, without making any specific finding of value, ruled that the debtor was "more insolvent" than it had been in 1962 (III 266; Pet. App. 19a–20a).

securities laws—violations which, they alleged, entitled them to rank on a parity with general creditors—were untimely made.

Early in 1959 the district court confirmed a plan of reorganization recommended by the Chapter X trustee, respondent Anderson, which would have given control of the corporation to the holders of preferred ship mortgages on the debtor's vessels ("the Caplan mortgage") (II 473, 580).[4] Anderson resigned as trustee to become president of the reorganized debtor (I 38; II 525).

The petitioner stockholders committee appealed from the order of confirmation, challenging "the failure of the trial court to order the trustee to conduct an investigation * * * and [the] failure of the court to conduct a hearing on insolvency of the debtor and to make findings of its assets and prospective earnings" (*TMT Trailer Ferry, Inc.* v. *Anderson,* 292 F. 2d 455, 458 (C.A. 5), certiorari denied *sub nom. Shaffer* v. *Anderson,* 368 U.S. 956). While that appeal was pending, the Commission filed in the district court a petition for an investigation, asserting that "an investigation would disclose that the reorganization plan would be unfair in turning the corporation over to persons, or close associates of persons, who had dealt extensively in the stock of the company in transactions which * * * were of questionable legality * * *" (*id.,* p. 457). At a hearing on objections to consummation of the plan, all the parties agreed that an investigation should be made (*ibid.*).

[4] In the petition these persons sometimes are called the Shaffer-Spitzer group.

Anderson, who had been reinstated as trustee (I 41), conducted an investigation. He concluded that the debtor's business had been "wrecked by gross mismanagement, by unwise and unsound expansion financed primarily through the sale of securities in disregard of the protective provisions of the Securities Act of 1933" (II 584), and that the debtor had claims against holders of the Caplan mortgage based on such mismanagement (II 606, 609, 614). The trustee recommended that the order confirming the 1959 plan be vacated (I 294). The district court vacated the order, and the court of appeals affirmed. *TMT Trailer Ferry, Inc.* v. *Anderson, supra.*

Early in 1962, two new plans of reorganization were proposed (II 41, 637). One plan, known as the "internal plan," provided for reorganization of the debtor by issuance of new common stock to its creditors (II 41.7, 41.10, 694–695). The other plan, known as the cash plan, provided for the sale of the debtor's assets for cash to persons unconnected with the company, and the distribution thereof to the creditors (II 637, 711). Neither plan provided for any participation by the stockholders. The stockholders committee, supported by the Commission, objected to both plans on the ground that the stockholders were improperly excluded and further objected to the internal plan because it contemplated employing the trustee as president of the reorganized company (II 1086, 1087). After hearings on valuation, the district court found that the debtor was insolvent, and approved both plans as fair and equitable and feasible (II 380, 387.5–387.8).

A majority of all classes of creditors (other than the United States, which had a non-tax claim exceeding $900,000) accepted the internal plan (II 388). No acceptances were solicited from the stockholders. In February 1963, the district court confirmed the plan (II 881).

In an appeal from the order of confirmation, the stockholders committee (supported by the Commission) contended that the plan was objectionable because it improperly excluded stockholders and contemplated that the trustee would serve as president of the reorganized company. The court of appeals, without reaching the other issues, held that the latter fact did not invalidate the plan.[5] In a separate appeal by the United States, however, the court held that the plan was defective because it failed to accord priority to the government's claim, and remanded the proceeding to the district court to determine whether the plan would be feasible with a provision for such treatment.[6]

After further hearings, the district court authorized amendments to the plan, primarily to provide for the immediate cash payment of the United States' claim (III 71). The creditors accepted the amended plan (III 316, 325) and, over objections by the committee (III 336) and the Commission (III 325), the district court confirmed it (III 328). The court of appeals affirmed (Pet. App. 6a–13a).

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[5] *Protective Committee, Etc.* v. *Anderson*, 334 F. 2d 118 (Pet. App. 3a).

[6] *United States* v. *Anderson*, 334 F. 2d 111, certiorari denied, 379 U.S. 879.

2. THE CLAIMS ASSERTED AGAINST THE DEBTOR

a. *The claims of the holders of the Caplan mortgage.* In his report of investigation in which he concluded that the debtor's business had been "wrecked by gross mismanagement" (*supra,* p. 4), the trustee detailed the manner in which the holders of the Caplan mortgage had dominated and controlled the financial affairs of the debtor. He concluded that they appeared to have violated the federal securities laws (II 612); that causes of action existed against them and that the debtor had defenses to their claims (II 606); that their claims should be subordinated to claims of innocent parties (II 614); and that they should be required to account for profits made through taking personal advantage of corporate opportunities (II 609).

After the trustee had filed his report of investigation and the district court had vacated its order confirming the 1959 plan (*supra,* p. 4), both the trustee and the Commission filed objections to the Caplan mortgage claim. They sought to have this claim, in the principal amount of $330,000, either "disallowed in toto or * * * subordinated to the claims of general creditors, including stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 * * *." (II 1093, 1096). The district court held no hearing on these objections. The plan that the court ultimately approved and confirmed, however, provided for a "compromise" under which $280,500 (the amount paid for the mortgage) was to be paid in cash

in five annual installments;[7] and interest on the mortgage was to be treated as an unsecured claim (III 272).

b. *The Merrill-Stevens claim.* Merrill-Stevens Dry Dock and Repair Co. ("Merrill-Stevens") filed claims totalling $1,628,284, of which $574,580 allegedly was secured by maritime liens on certain of the debtor's vessels (II 23). More than $1,000,000 of these claims were for the unpaid balance of Merrill-Stevens' charges for the conversion of one of the debtor's vessels from a partially-completed naval ship into a self-propelled trailership. On its maiden voyage a series of boiler failures had caused a breakdown of the vessel, necessitating extensive repairs.

Following an investigation, the Commission in 1961 filed objections to these claims, urged that the trustee investigate them, and suggested that they should be referred to a special master for hearing (II 1093). The Commission concluded that the boiler failures may have resulted from Merrill-Stevens' negligence in performing its work of converting the vessel, and that the debtor therefore might be able to offset against the claims the expenses of repairing the vessel (III 405).

Although the trustee initially sought a reference to a special master for a hearing on the claims (II 862), no such hearing was held. Instead, the trustee subsequently moved for the summary allowance of the Merrill-Stevens claims, on the ground that there was only

[7] The plan later was amended to provide for the immediate payment of $250,000 in cash at the time of consummation, instead of $280,500 over five years (order entered September 21, 1965).

a "remote" possibility of materially reducing them by litigating the objections filed against them (II 22). Despite objections by the stockholders committee, which the Commission supported (II 37, 1042, 1073), the plan ultimately approved and confirmed allowed these claims in full, although the secured portion was reclassified as unsecured. The effect of thus allowing these claims was to give Merrill-Stevens about 40 percent of the common stock of the reorganized company (III 251–252, 282).

c. *The stockholders' claims based on alleged violations of the federal securities laws.* Based substantially on the facts in the trustee's report of investigation, the stockholders committee repeatedly asserted in various ways, including the filing of formal proofs of claim, that non-management stockholders had claims against the debtor, based upon violations of the federal securities laws, that were entitled to parity treatment with the claims of general unsecured creditors—irrespective of the solvency or insolvency of the debtor. It made this contention to the district court in connection with the formulation, approval and confirmation of the plans of reorganization. (II 363, 364, 962, 1037, 1039, 1074, 1083, 1086–1088).

The district court, without an evidentiary hearing, denied these claims (II 379–380). It stated:

> There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from

> the debtor * * * and the time for filing claims expired several years ago.
>
> * * * * *
>
> Furthermore, the [Committee's] claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage. [II 379–380, emphasis in original.]

DISCUSSION

In a prior appeal in this case, the court of appeals held in 1964 that "[t]he plan is not to be rejected merely because Anderson, the trustee, would become president of the reorganized company * * *" (Pet. App. 5a). But since, despite that ruling, the trustee might not have become president,[8] the question whether such employment would violate the requirement in Section 156 of the Bankruptcy Act that he be "disinterested" was not then ripe for review. The issue is now ripe, however, since the final plan, which the court of appeals approved, contemplates that the trustee will become president (II 707).[9]

[8] The court of appeals remanded the case for a determination whether the plan would be feasible if the non-tax claims of the United States were given priority, and it recognized that if such a change would render the plan unfeasible, a "new plan, based upon an updated determination of insolvency, can be submitted" (Pet. App. 3a). Under such new plan the trustee might not have become president of the reorganized company.

[9] Although this apparently is the first appellate decision discussing the point, there have been several other cases in which a Chapter X trustee has succeeded as president of the reorganized company. See, *e.g.*, *In the Matter of F. L. Jacobs*, E.D. Mich., No. 42235; *In the Matter of Yuba Consolidated Industries*, N.D. Cal., No. 64103; and *In the Matter of Inland Gas Corp.*, E.D. Ky., No. 115.

The last opinion of the court of appeals seemingly rests on narrow grounds turning on the facts of this particular case—factors that ordinarily would suggest that there is no occasion for further review. Thus the court of appeals, after holding, contrary to the view of the district court, that its decision in the prior appeal "left open those issues not in terms discussed and decided" (Pet. App. 8a), ruled as follows: (1) The district judge had justifiably refused to "consider * * * on their merits" the claims of the stockholders that, based on violations of the federal securities laws, they were entitled to be treated as creditors in the reorganization plan, since he had not "abused his discretion" in concluding that such claims had not been timely filed (Pet. App. 8a–10a). (2) The district court had not erred in approving without a hearing the compromise of "approximately $2,000,000 in two seriously disputed claims" or in ruling, without attempting to value the debtor "when reorganized" (II 170), that it was insolvent both in 1962 and in 1965 (Pet. App. 10a–30a). It explained: "We are not called on to decide whether the district court has accurately computed the going concern value of the debtor and the amount of the creditors' claims, but only whether its decision that the debtor is insolvent is clearly erroneous. * * * The finding of insolvency cannot be held clearly erroneous" (Pet. App. 13a).

We believe that these rulings, however limited their scope may appear initially, in fact rest upon serious misconceptions of the governing standards in Chapter X proceedings, and reflect a failure of the court of appeals adequately to supervise the conduct of this reorganization by the district court. Congress has

recognized the broad supervisory responsibility of courts of appeals in Chapter X proceedings by making applicable to such proceedings the liberal appellate review practice followed in bankruptcy generally. See Sections 24, 25, 121, and 250; *McClelland* v. *Greenberg*, 142 F. 2d 245, 248 (C.A. 2).

The court of appeals apparently was substantially influenced by its view that "[t]his nine-year-old litigation must at long last be brought to an end" (Pet. App. 13a). The Commission is no less concerned than the court of appeals about the delay in this reorganization.[9a] But the desirability of terminating a protracted proceeding certainly does not outweigh the importance of correcting the serious errors that the district court committed in this case.

1. One of the major reforms that Chapter X provided for corporate reorganizations was the requirequirement in Section 156 that "[a]ny trustee appointed under this chapter shall be disinterested * * *." The legislative history of Chapter X shows that Congress contemplated the disinterested trustee would be the "focal point" of the reorganization;[10] that Congress recognized that his functions were "difficult to overemphasize";[11] and that the requirement that he be disinterested was designed to eliminate past reorganization abuses that had resulted from "friendly" trustees.[12] In short, as the Commission (which recommended the legislation) told the

[9a] During the reorganization the debtor has continued to operate, and indeed has expanded its operations (II 310.1, 864).

[10] H. Rep. No. 1409, 75th Cong., 1st Sess. 43 (1937).

[11] *Ibid.*

[12] S. Rep. No. 1916 on H.R. 8046, 75th Cong., 3d Sess. 21 (1938).

Congress, "the independent trustee is the key to real reform. In comparison, the other reforms are secondary."[13]

Section 158 specifies that a person "shall not be deemed disinterested" if he comes within three categories of relationships with the debtor,[14] or if "it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor * * * or for any reason an interest materially adverse to the interests of any class of creditors or stockholders." We submit that a trustee who intends or contemplates that he will become president upon reorganization of the debtor has "an interest materially adverse to the interests" of the creditors and stockholders of the debtor within the meaning of the foregoing provision, and therefore is no longer "disinterested."

Throughout the reorganization the trustee repeatedly is called upon to make recommendations and decisions that vitally affect both the size of the estate and the participation therein of creditors and stockholders. Although the court bears the final responsibility for passing upon all steps in the re-

[13] See testimony of then Commissioner Douglas in *Hearings before the House Committee on the Judiciary* on H.R. 6439, subsequently amended, reintroduced and reported as H.R. 8046, 75th Cong., 1st Sess., 177 (1937).

[14] If he (1) is a creditor or stockholder of the debtor, or (2) is, or was an underwriter of any of the debtor's outstanding securities or within five years had been an underwriter of any of the debtor's securities, or (3) is, or was within two years of the filing of the petition, a director, officer or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter.

organization process, the trustee plays a vital role in assisting the court in the proper performance of that function. He conducts any investigation that may be necessary, evaluates and reports upon any claims in favor of the debtor that may thereby be disclosed, recommends the allowance and disallowance of claims against the debtor, generally plays a major role in the formulation of a plan of reorganization, and advises the court on a wide variety of other important matters (see Sections 167, 169, 196, and 197).

Unless the trustee is completely disinterested, however—that is, unless there is a complete absence of any factor that, consciously or unconsciously, might tend to cause personal considerations to influence him—he is not able to provide "an informed judgment and to afford a critical scrutiny and supervision of the estate at all times" [15]—the function that Congress intended him to perform.

In the present case, for example, when two plans of reorganization were proposed in 1962, the trustee recommended to the court the internal plan—which specifically contemplated that he would become president of the reorganized company (Pet. App. 4a) [16]—

[15] H. Rep. No. 1409, 75th Cong., 1st Sess., 43 (1937).

[16] On May 2, 1962, during the hearings on approval of those plans, there was introduced into the record a proposed contract between the reorganized corporation and the trustee, his general manager and his sales manager, whereby the reorganized company would employ them as president, executive vice president and general manager, and vice president and national sales manager, respectively, the first two at $25,000 per year and the third at $17,500 per year (II 275, 296–298). This contract was specifically referred to in the internal plan of reorganization

and opposed the alternative plan for sale of the debtor's assets to third parties. In addition, there were serious objections to claims of two major creditors totalling approximately $2,000,000. The trustee decided not to pursue them and instead recommended a plan which allowed them almost in full and under which one of the creditors (Merrill-Stevens) will receive about 40 percent of the common stock of the reorganized company—an interest that will wield a commanding vote when it comes to selecting the new president. The likelihood that the trustee would become president of the company upon reorganization gave him "an interest materially adverse to the interests" of the public stockholders under Sections 156 and 158, which precluded a finding that the plan of reorganization was "fair and equitable" (Sections 174 and 221).

We do not suggest that the trustee's recommendations on these matters were deliberately designed to promote his personal interest.[17] But the requirement in Section 156 that the trustee be "disinterested" is to avoid even the possibility of such

(II 707). The court of appeals recognized that the contract was "between the major creditors and the trustee" (App. 4a).

The earlier plan that had been confirmed contemplated that Anderson would become the salaried president of the debtor upon its reorganization; and, as noted (*supra*, p. 3), upon confirmation of that plan Anderson resigned as trustee in order to assume that office and a successor trustee was appointed. The latter was subsequently removed before the order of confirmation had been vacated and Anderson was reinstated as trustee (I 40–41).

[17] The district court noted, however, that in considering two plans, one of which provided for his future employment and one of which did not, the trustee "would be perhaps inclined to lean to his employment" (II 332).

conflicts of interest. For the evil is not that "such interests are always corrupt but [that] they are always corrupting." (*Mosser* v. *Darrow*, 341 U.S. 267, 271); "the incidence of a particular conflict of interest can seldom be measured with any degree of certainty" (*Woods* v. *City Bank Co.*, 312 U.S. 262, 268). Cf. *Wolf* v. *Weinstein*, 372 U.S. 633, 642, 654.

The court of appeals seemingly indicated that the touchstone of disinterestedness was whether the proponents of a plan "assured" the trustee of future employment with the debtor or merely intended to recommended it to the court and the board of directors (Pet. App. 4a–5a). Such a distinction would be unworkable in practice, since sophisticated business men would have no difficulty in reaching understandings that stop short of formal agreements. Moreover, it would seriously weaken the protections which the requirement of a disinterested trustee was intended to provide for creditors and stockholders. For the probability of future employment may create just as great a danger of a conflict of interest as its certainty. Section 156 must cover both situations if it is to achieve the salutary purpose that Congress intended it to serve.

2. In affirming the district court's approval of the plan embodying the "compromises" of two substantial claims and upholding the district court's finding of insolvency as not clearly erroneous, the court of appeals (a) departed from the settled principle that compromises in Chapter X proceedings of substantially disputed claims may be approved only on the basis of a complete record that permits an informed

judgment as to the merits of the claims and the basis of the settlement; and (b) failed to follow the standards for determining valuation that this Court has prescribed in corporate reorganizations.

a. Under the confirmed plan the $330,000 Caplan mortgage claim is to be "compromised" by paying the holders thereof $280,500 (the amount they paid therefor) over five years [18] and giving them stock for their interest claims; and the Merrill-Stevens claim of $1,628,284 is to be "compromised" by reclassifying the allegedly secured portion thereof (approximately $575,000) as unsecured, and issuing for the entire claim approximately 40 percent of the common stock of the reorganized company. The record contained no evidence, however, upon which the merits of these claims could have been evaluated, and the district court did not make "an informed independent judgment" (*National Surety Co.* v. *Coriell,* 289 U.S. 426, 436) thereon. The decision of the court of appeals approving the compromise in such circumstances is accordingly inconsistent with such decisions as *Ashbach* v. *Kirtley,* 289 F. 2d 159 (C.A. 8), *In re Chicago Rapid Transit Co.,* 196 F. 2d 484, 488 (C.A. 7), and *Conway* v. *Silesian-American Corp.,* 186 F. 2d 201 (C.A. 2), which recognized that a district court cannot properly appraise the fairness of a compromise of disputed claims in a reorganization without an adequate record thereon.

Thus, in *Ashbach,* the court of appeals reversed an

[18] The plan subsequently was amended to provide for the payment of $250,000 immediately upon consummation. See note 7, *supra,* p. 7.

order of the district court which had approved, after a hearing at which no testimony had been introduced, a compromise settlement of a judgment obtained by the trustee. The court of appeals stated that in the light of the "paucity of information furnished to the court by the trustee and his counsel," "there were too many questions left unanswered for the court to arrive at that 'informed and independent judgment' referred to * * * in *National Surety Co.* [*supra*]" (289 F. 2d at 166). Similarly, in *Conway,* the court of appeals reversed the lower court's approval of a Chapter X plan of reorganization which compromised conflicting claims by a group of Swiss banks, stating "we are compelled to find a lack of sufficient proof of the adequacy of the settlement proposed to justify acceptance of the plan as fulfilling the statutory standards ['fair and equitable' requirements of Sections 174 and 221(2) of Chapter X]" (186 F. 2d at 212). And in *Chicago Rapid Transit,* the court of appeals reversed an order approving a "businessman's settlement" of mutual claims between the debtor and a former lessor because it was made "solely on the basis of expediency and the desire to forestall further lengthy and expensive litigation, with no attempt at considering the relative merits of the conflicting claims of the parties" (196 F. 2d at 485). Similar objections apply to the compromise of the Caplan mortgage and Merrill-Stevens claims in the present case.

b. The district court's error in approving the compromise without an adequate record has a particularly serious impact upon the public stockholders (who

have been excluded from participation in the reorganized company) because of the court's further error in applying an erroneous method of valuation in determining that the debtor was insolvent. This Court repeatedly has stressed that an informed estimate of the future earnings of a reorganized company is essential to a proper determination of valuation. See, *e.g., Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510, 526, and *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523, 540. In *Consolidated Rock* this Court, although acknowledging that mathematical precision in predicting future earnings cannot be expected and that an estimate is all that can be made, stated that such estimate "must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including * * * all circumstances which indicate whether or not * * * [the past earnings] record is a reliable criterion of future performance." 312 U.S. at 526.

In the present case, however, the district court failed to follow these principles, and instead used an impermissible method of valuation. The court stated that the debtor is to be valued "as it now exists" (II 170), that "[t]here is [*sic*] no future prospects other than what is going on" (III 55–56), that the "only reliable factors are what the debtor is doing now" (II 387.7), and that its value "when reorganized" is "of no importance" (II 170). In 1962 the district court valued the debtor by simply projecting its existing earnings on the same level for the next several years (II 387.5). This calcu-

lation was improper because it failed to reflect foreseeable increases in revenues that seemed likely because of an increasing demand for the debtor's services, and the likelihood that the trustee would shortly purchase additional vessels and trailers (II 310.1, 864). Moreover, the then current earnings reflected a deduction of reorganization expense which, of course, was not an ordinary business expense (II 267). After the remand of the court of appeals the district court in 1964–1965 did not attempt to make any further valuation of the debtor, but merely concluded on the basis of its then current earnings that it was "more insolvent" than it had been two years previously (III 266).

3. Most of the facts upon which the stockholders' claims rest were first uncovered during the trustee's investigation (*supra,* pp. 4, 6). His report of investigation was filed on July 1, 1960, more than two years after the April 4, 1958, date the district court had set for the filing of claims. On the basis of his investigation, the trustee recognized that "stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934" had claims as "general creditors" against the debtor (II 1096).[19]

[19] If such stockholder claims can be established, they are entitled to rank on a parity with those of other general unsecured creditors. See *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206; *Clark* v. *Boston-Continental National Bank*, 84 F. 2d 605, 607 (C.A. 1); and *Salter* v. *Williams*, 244 Fed. 126, 130 (C.A. 3), cited with approval by this Court in *Oppenheimer.*

Unlike ordinary creditors who, at the outset of a Chapter X proceeding, are aware of their claims against the debtor based upon such matters as credit extended or services performed, the 7,000 stockholders here involved were not aware of their claims based upon alleged violations of the federal securities laws until after the trustee filed his report, long after the commencement of the proceeding. While the facts as to each of the claims may vary, their legal theory involves common questions of law. Accordingly, it would have been appropriate for the trustee, as an "arm of the court",[20] to have devised a procedure pursuant to Section 196 to determine the legal questions before formal proofs of claims would have had to be filed. Moreover, since the original date for the filing of claims had expired before these claims became known, the district court should have at least set a new filing date for them. See *In re United Cigar Stores Co. of America*, 82 F. 2d 744, 745 (C.A. 2), stating that "notwithstanding the expiration of the time limit for filing proofs of claims, the court will grant to a creditor leave to file such proof unless the proceedings have reached such a point that their purpose would be frustrated or substantial rights of other creditors be impaired by such permission."[21]

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[20] H. Rep. No. 1409, 75th Cong., 1st Sess., 43 (1937).

[21] In ruling that the district court had not abused its discretion in refusing to consider the claims on the merits, the court of appeals stated (Pet. App. 10a): "To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to liquidate and which might have delayed indefinitely the formulation of any plan of reorganization, would have been extremely prejudicial to the creditors." But if, as we have argued, the dis-

When it appeared that the trustee was ignoring these claims, however, the stockholders committee, in March 1961 and on numerous occasions thereafter, formally advised the court of the claims. In June 1962 it filed a proof of claim (II 364), as did a stockholder acting on behalf of all (II 358). Since such claims go "beyond the objector's individual interests and * * * [affect] the fairness and equity of the plan," [22] the district court should have considered them on the merits. For the reorganization court must be "diligent to protect itself and the public from approval of unfair plans, even by default * * *" (*Comstock* v. *Group of Institutional Investors,* 335 U.S. 211, 227).

With the increasing development of private rights of action under the federal securities laws,[23] claims

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trict court had the obligation to consider the claims, the court's failure to perform that obligation cannot be justified on the ground that to have done so would have caused further delay. Cf. *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 114, where this Court pointed out that "All those interested in the [debtor's] estate are entitled to the court's protection." Here, as shown above (*supra*, p. 19, n. 19), if the claims are valid the stockholders are entitled to participate in the estate on a parity with other creditors; and the failure to accord them such participation precluded a finding that the plan was fair and equitable. Moreover, as the court of appeals recognized in one of the earlier appeals in this case, the creditors of the debtor had no vested rights in the plan of reorganization prior to its consummation, and certainly not prior to the time the stockholders committee first made the claims. *TMT Trailer Ferry, Inc.* v. *Anderson*, 292 F. 2d 455 (C.A. 5).

[22] *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 227, 235; cf. *Young* v. *Higbee Company*, 324 U.S. 204, 214.

[23] See, *e.g.*, Fleischer, "*Federal Corporation Law*": *An Assessment*, 78 Harv. L. Rev. 1146 (1965).

similar to those asserted by the stockholders here have been, and are being, asserted in other Chapter X proceedings.[24] The rule applied by the district court in this case and approved by the court of appeals would have a seriously inhibiting effect upon the proper judicial evaluation of such claims.

CONCLUSION

The decision of the court of appeals rests upon the application of erroneous legal principles. The issues are of sufficient importance in the administration of Chapter X of the Bankruptcy Act to warrant review by this Court. The petition for a writ of certiorari should therefore be granted.

Respectfully submitted.

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MARCH 1967.

[24] See, *e.g.*, *In the Matter of Food Town, Inc.*, Md., No. 11070, and *In the Matter of General United Corporation, Inc.*, D. Kan., No. 3763–B–1.

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1966

No. 952

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner,

-vs-

C. GORDON ANDERSON, TRUSTEE,
Respondent.

REPLY OF RESPONDENT TO MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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REPLY OF RESPONDENT TO MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

STATEMENT

The court invited the Solicitor General to file a brief expressing the views of the United States in this case, and he has submitted a memorandum "for the Securities and Exchange Commission."

The Solicitor General's memorandum fails to mention the interest that the United States has had in this case as a

major creditor of the debtor, an interest of more direct concern than the purely advisory function of the SEC under Section 172 of the Bankruptcy Act. The tax claims of the government totaled approximately $192,000 and the non-tax claims about $905,000 (III 224).

The initial plan of reorganization confirmed by the district court on March 6, 1959 (II 516-519) was rejected by the government because of inadequate provisions for payment of its claims. Negotiations thereafter between counsel for the Trustee and counsel for the government (represented by the Admiralty and Shipping Section, Civil Division, Department of Justice) resulted in settlement of those claims, and the plan was amended on November 4, 1959 (II 564-571) to provide for payment of the tax claims in installments over a 3 year period and for the government to receive for the non tax claims 27½% of the face amount of the claims in preferred stock of the reorganized debtor. The plan as thus amended was accepted by the Secretary of the Treasury (II 559-564).

This is the plan referred to by Petitioner (sometimes herein called the Stockholders Committee) as the Shaffer-Spitzer plan after the names of the trustees for the Caplan mortgage group. This plan was set aside after the Trustee's investigation in 1960 resulted in his recommendation to the court that the plan was not fair and equitable because of control being given to the Caplan mortgage group.

After the appellate court sustained the setting aside of the plan (*TMT* v. *Anderson*, 292 F.2d 455, *cert. denied*, 368 U.S. 956) the present plan of reorganization was evolved after a series of hearings and after negotiations involving settlements of various claims. The proceedings involving

the new plan were not concluded until mid-year 1962 or 3 years after the initial plan was approved. During this period the debtor prospered under the management of the Trustee. Net profits were $207,000 in 1959, $210,000 in 1960, $373,000 in 1961 and $524,000 in 1962 (III 77). As a result of these earnings and a going concern value of $2,780,000 found by the court based on the earnings (II 387.5) counsel for the United States insisted that the debtor could afford to pay the government *in full* and contended that the law required priority treatment not only of the tax claims but also of the non-tax claims for which in 1959 settlement was made at 27½¢ on the dollar taken in preferred stock.

We were unable to reach a settlement of the non-tax claims and the litigation over them resulted in the appellate court upholding the government's contention that they were entitled to priority the same as tax claims. (*United States* v. *Anderson*, 334 F.2d 111, cert. *denied*, 379 U.S. 879) This decision resulted in the amendment of the plan to provide for payment in full in cash of all the government claims totaling about $1,097,000 and the plan as so amended was approved by the district court on March 19, 1965 (III 260-271). In order to pay these claims in cash and meet other cash requirements for the consummation of the plan, the plan was further amended at the same time to authorize the reorganized company to borrow $1,250,000 from a bank on a long term loan secured by a mortgage on its vessels and vehicles.

Thus, it is apparent that the government as a major creditor has benefited materially from the success of the trustee in operating the business of the debtor. This success alone has enabled the government claims to be paid in full

because the value of TMT, as admitted by all parties, is not in its assets but in its going concern value as a transportation facility. It is therefore inconsistent for the Solicitor General in his brief to criticize that portion of the plan of reorganization, accepted and desired by the other creditors, which will enable the directors of the reorganized company to retain the valuable services of the Trustee if they desire to do so.

It is this amended plan which is the subject of the Petition in this cause. The district court directed the Trustee to proceed with the consummation of the plan on May 25, 1965 (III 389-395). Pursuant to this and subsequent directives which are not in the record before the court, the Trustee has substantially consummated the plan although no formal order of substantial consummation is contemplated until the proceedings in this court are concluded.

The government has, in fact, been paid approximately $1,100,000 on account of its claims, and all other claimants have likewise been paid. The reorganized company borrowed $1,250,000 in order to make these payments, as authorized in the amended plan. The common or unsecured creditors have been issued the new common stock of the reorganized company in satisfaction of their claims. The directors of the reorganized company, appointed pursuant to the plan in the order of May 25, 1965, supra, have taken over the assets of the debtor and are running its business.

The purpose of this discussion is to show the importance of the stake that the government has in TMT as a major creditor, in fact the largest creditor except for Merrill-Stevens, an unsecured creditor. As a large preferred creditor whose claim has been allowed and paid, the

government should be concerned with upholding the plan and bringing to a conclusion the extended litigation that has prevented its final consummation. We are unable to predict what the effect might be on the government's position as a creditor should this court require the forming of a new plan with provisions materially different from the present one as sought by the Stockholders Committee. It is our opinion that until a Final Decree is entered, as provided in Section 228 of the Bankruptcy Act, discharging the debtor from its debts, there remains the possibility of redetermination with respect to any issue involved in the reorganization including those providing for the payment of any claims.

It appears that the government's interest as a major creditor is adverse to its championing the interests of a Stockholders Committee. The Solicitor General should have taken a position the same as other creditors, namely that the rights of stockholders have been thoroughly considered and determined in the lower courts and that the plan of reorganization should not be disturbed by this court.

THE CONTENTION THAT THE TRUSTEE SHOULD NOT BE PERMITTED TO BE EMPLOYED BY THE REORGANIZED DEBTOR.

This issue is not properly before the court because it was not decided by the Fifth Circuit in the opinion which is the subject of these proceedings. It was decided by the Fifth Circuit in the *prior appeal (In re TMT Trailer Ferry, Inc.*, 334 F.2d 118, dated June 8, 1964) and thereby became the law of the case.* The opinion sought to be

*See: *General American Life Ins. Co.* v. *Anderson*, 156 F.2d 615, 618-619 (C.A.6, 1946).

reviewed here (App. 6a, Petition for Writ of Ceriorari herein) is dated August 12, 1966, and does not discuss this issue but merely mentions in passing that it was decided in the former appeal.

The entire argument of the Solicitor General on this point is directed to the Fifth Circuit opinion in the 1964 decision and not to anything in the opinion sought to be reviewed. He tries to get around this by asserting on page 9 of his brief that the issue "was not then ripe for review" (in 1964) but "is now ripe" since the "final plan . . . contemplates that the trustee will become president." This is not accurate for the issue was as ripe then as it is now.

The plan of reorganization, as revised by the District Court following the 1964 remand, contains the *identical* provisions with respect to the officers, directors and corporate structure of the reorganized debtor as was contained in the plan reviewed by the appellate court in 1964. With respect to the possible employment of the Trustee, the language in the plan is:

> "It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the court." (III 247)

The district court in its order approving the amended plan (App. 14a, Petition for Writ of Certiorari herein) made it plain that no new plan of reorganization was being considered but that the plan was being amended only to meet the requirements of the appellate court with respect

to the priority of the government non-tax claims and to make certain other minor clarifying changes. The district court opinion and order does not discuss the issue of the Trustee's employment *because it was not raised* when the amended plan was considered. The record shows that when the matter was heard (III 351-357) the court asked twice (III 356) if there were any comments or objections to the names of those proposed for appointment as the new directors of the reorganized company and there were none *even from counsel for the Stockholders Committee* who was present. The Trustee was one of the new directors.

The raising of this issue before this court on behalf of the Securities and Exchange Commission is even more inexplainable because the SEC did not object to the provision in the amended plan for the employment of the existing management. The SEC filed a lengthy report on the amended plan (III 215-242) but it made no comment on the subject except to note that the Fifth Circuit 1964 opinion "sustained the provisions in the Internal Plan with respect to the employment of the Trustee as president of the reorganized company." (III 223) Nor did the brief filed by the SEC in the appeal of the present plan to the Fifth Circuit discuss the issue of the employment of the trustee.

It is apparent that all parties, including the district court and the appellate court, considered that the 1964 opinion of the Fifth Circuit settled the issue. It became the law of the case and is not a proper subject for further review.

Regarding the merits of this issue, the court should decline what amounts to a suggestion by the Solicitor General that the court amend the Bankruptcy Act to include a

standard for determining disinterest which was omitted by the Congress. Section 158 of the Bankruptcy Act specifies who shall be considered a disinterested trustee and it fails to state that an interest in the management of the debtor after its reorganization is a disqualification. It is significant that the record of these proceedings, now in their tenth year, contains no assertion that the Trustee, who has served from the beginning, is in any way disqualified to act even though he was tagged as far back as the initial 1959 plan of reorganization to be the president of the reorganized company. If the Solicitor General's contention is correct the Trustee has been disqualified to serve for many years.

Section 216 of the Bankruptcy Act specifies what a plan of reorganization must contain and provides:

> "(11) shall include provisions which are equitable, compatible with the interests of creditors and stockholders, and consistent with public policy, with respect to the manner of selection of the persons who are to be directors, officers, or voting trustees, if any, upon the consummation of the plan, and their respective successors;"
>
> * * * *
>
> "(14) may include any other appropriate provisions not inconsistent with the provisions of this chapter."
>
> Sec. 216 (11) and (14) of the Bankruptcy Act.

The opinion of the district court, prior to the 1964 decisions of the Fifth Circuit, in approving the provision in the plan authorizing the continuation of the Trustee's

management made specific findings implying that the provision in this case was in the best interests of the parties concerned. The court said:

> "The SEC memorandum also objected to the provision in the Internal Plan which contemplates that the reorganized company may employ the Trustee as its president. This provision, however, is not mandatory on the reorganized company and was inserted at the insistence of the court for the purpose of making full disclosure of what had come to the attention of the court. Both the trustee and the creditors' committee had advised the court that certain of the largest unsecured creditors who favored an internal plan wanted the present management retained. There is nothing in the law which precludes a trustee from accepting employment from the reorganized company, and certainly the creditors concerned are entitled to insist on good management acceptable to them." (II 378)

The background of this finding is important. The plan finally approved was initially proposed by a *court appointed committee of attorneys* (II 41), experienced in bankruptcy matters, charged with protecting the interests of unsecured creditors as a class. This committee included in the initial draft of the plan later adopted a provision expressly contemplating the retention of the present management by the reorganized debtor (II 41.11) and suggested a form of contract which was eliminated from the plan before it was approved. It was finally decided to leave to the discretion of the directors of the reorganized company whether the trustee and his staff would be retained, and the present provision in the plan was inserted in order to advise every-

one concerned that retention of the Trustee was under consideration.

The arguments advanced by the Petitioner and the Solicitor General are designed to lead the court to believe that the principal objective of the Trustee was to make a job for himself. Petitioner's counsel condemns the alleged conflict of interest with denunciatory fervor that is scandalous in its implications. The truth is that the trustee has done a rare and exceptionally competent job in the operation of the business of the debtor, taking over when operations had ceased and developing traffic successfully in the highly competitive maritime field and without the benefit of the government subsidies necessary to keep many of the large shipping companies alive. It was almost inevitable that under such circumstances the creditors concerned would want this successful management retained, or at least not be *precluded* from using the trustee and being *forced* to employ some stranger to the operation.

The argument of the Solicitor General is not sound. He engages in the assumption that as a matter of law a trustee who *intends* or *contemplates* that he will become president upon reorganization *necessarily* has an interest adverse to the interests of creditors and stockholders. This assumption belies human nature for a person with an incentive will do a better job than one marking time knowing there is no future for him. In any event, as the Fifth Circuit decision held, the TMT Trustee is not *assured* of future employment but his job will depend entirely on the new directors.

Nor did Congress ever intend to make the test of "disinterest" dependent upon the subjective *intention* or

contemplation of the trustee. The statutory tests in Section 158 of the Bankruptcy Act are all objective tests, and the Solicitor General would write into the section words and meanings that are not there.

Congress was given an opportunity to write into the statute the very intent urged by the Solicitor General, but failed to act. On March 24, 1958, Congressman Celler introduced H.R. 11589, which proposed that Section 216 of the Bankruptcy Act (describing the provisions to be included in a reorganization plan) be amended. The bill was referred to the Committee on the Judiciary, which apparently did not act upon it except to the extent indicated in the next paragraph.

SEC's 24th Annual Report (pp. 9-10) says that H.R. 11589 was one of nine draft bills to amend the Bankruptcy Act which SEC itself filed with the Judiciary Committees of the House and Senate. The Report then states of these bills that

> "... They were referred to the Judicial Council of the United States Courts for review and a conference was held by the Commission with the Council in August, 1958, at Denver, Colo. No further action was taken on these bills by the Congress."

Mr. David Ferber, solicitor for the SEC, and others on his staff wrote an article in the 1959-60 George Washington Law Review (28 Geo. Wash. Law Rev. 319) in which they discuss conflicts of interest and state in a footnote on page 382 that HR 589 [sic] in the 85th Congress was sponsored by the SEC for the purpose of prohibiting a

trustee or his attorney from being employed by a reorganized company for a period of two years after substantial consummation of a plan. We suggest that the SEC knows that this is a matter to be determined by Congress, that the Fifth Circuit decision has interpreted correctly the statute as presently written, and that this court should not add a restriction not expressed or clearly implied in the existing law.

There is, as admitted by the Solicitor General, no decision on this issue contrary to the opinion of the Fifth Circuit sought to be reviewed.

THE CONTENTION THAT CERTAIN STOCKHOLDERS SHOULD BE AFFORDED OPPORTUNITY TO PARTICIPATE IN THE REORGANIZED DEBTOR.

The brief of the Solicitor General erroneously assumes that large numbers of stockholders are entitled by law to assert claims against the debtor and that they have been improperly prevented from doing so. The position of the Trustee is that in addition to such claims being barred by laches, the facts in the record with respect to the alleged merits of the claims show clearly that they would be without merit and, if established, would necessarily be subordinate to the claims of existing creditors.

The Solicitor General implies that the district court did not consider the alleged stockholder claims on their merits, but summarily disposed of them solely because the debtor was insolvent and the claims not timely filed. This is not accurate because the denial of the two claims filed shows that the facts upon which they were based were

considered by the court. The complete statement of the court on the subject says:

> "Another proposal, however, was that certain stockholders should be permitted to participate as unsecured creditors upon filing and proving up claims based on rescission of their purchase of the stock. There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from the debtor. No such claims had theretofore been filed and the time for filing claims expired several years ago. The proposal would arbitrarily set aside 25% of the common stock under the Internal Plan for the benefit of stockholders who could prove a right to rescind. The equity of the unsecured creditors cannot be diluted in this manner.
>
> The Stockholders' Committee also filed a PROOF OF CLAIM FOR RESCISSION on behalf of unnamed stockholders who purchased stock of the debtor on the open market. The facts stated in this document are insufficient to show that any stockholders as a class or individually have valid claims against the debtor. Furthermore, the claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage.

Likewise, the claim filed by Irma S. Mason, wife

> of a member of the Stockholders' Committee, seeking to rescind her purchases of TMT stock on the open market is without merit for the same reasons. It shows that her damages, if any, are recoverable against others than the debtor."
> (II 379-380)

The above shows clearly that the court considered the factual basis for the assertion of the claims and rejected them primarily on their merits.

The facts with respect to the claim of stockholder Irma S. Mason are asserted fully in her claim (II 358-363) including reference to the facts developed in the Trustee's 1960 investigation. (II 579-617) She seeks to recover from the *debtor* what she paid for her stock *on the open market* more than nine months before the reorganization proceedings began. She seeks to *rescind* her purchase and hold the *debtor* liable for the purchase price because of an alleged conspiracy between the debtor and its financial advisors which resulted in the market being flooded with "illegally issued stock" of which hers is *probably* a part.

The other claim (II 363-368) was filed by the Stockholders Committee "on behalf of all non-management stockholders" and seeks to rescind purchases made on the open market. Both claims list a series of facts intended to show that the stock was dumped on the open market by persons closely associated with the debtor who should have held the stock for a certain period under the securities laws, and that the public was misled as to the financial condition of the debtor by various statements and reports which were not accurate. Most of the facts relied upon were detailed in the Trustee's Report of Investigation (II 579-617) with

which the court and all parties had been familiar for more than two years prior to the filing and denial of the two claims.

It is therefore obvious that the district court denied the stockholder claims on their merits based on sufficient facts in the record to show their character. That they should be without merit as a matter of law is apparent upon careful analysis. There is no privity whatever between these stockholders and the debtor and ordinarily a defrauded buyer's right to rescind his purchase exists only against the person who sold the subject matter to him. Rescission implies that the parties can be restored to the status quo which existed prior to the alleged fraud. But that cannot be done as the considerations for the purchases of the stock were not paid to the debtor but to persons in the open market. The district court properly indicated that the remedy was against persons other than the debtor.

The effect of the position taken by opposing counsel would be to make the debtor the underwriter of all the market losses in the corporation's stock simply by virtue of stock having been put on the market that should not have been resold by the "insiders" involved. We have found no authority for such a position and none is cited in the opposing briefs.

Even if stockholder rescission claims were allowed they would necessarily be subordinated to the claims of trade creditors and lenders. All of the cases cited by the Solicitor General in the footnote on page 19 of his brief, as authority for the statement that such claims would rank on a parity with general unsecured creditors, arise from national bank liquidation under the National Bank Act.

(12 U.S.C. Sec. 21 et seq.) This act provides that "the comptroller (of currency) shall make a ratable dividend of the moneys so paid over to him by (a) receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction." (12 U.S.C. Sec. 194.) Distribution thus is not entrusted to a court of equity empowered to determine the order of distribution, but to an administrative official bound by a statute which directs ratable distribution *on all claims.* The unique nature of national bank proceedings was noted by this court in *Cook County* v. *United States,* 107 U.S. 445, where it was faced with the question as to whether the United States' statutory priority of payment for debts due to it applied in a case of an insolvent national bank. The court stated that

> " . . . the act authorizing the formation of national banks . . . constituting by itself a complete system for the establishment and government of national banks . . . Everything essential to the formation of the banks, the issue, security, and redemption of their notes, the winding up of the institutions, and the distribution of their effects, are fully provided for, as in a separate code by itself, *neither limited nor enlarged by other statutory provisions with respect to the settlement of demands against insolvents or their estates.*" (107 U.S. at 448) (emphasis supplied)

This court held that R.S. 5236 (12 U.S.C. Sec. 194) "provides for the distribution of the entire assets of the bank, *giving no preference to any claim* except to moneys to reimburse the United States for advances in redeeming notes." *(Id.* at 450) (emphasis supplied)

The proposition propounded by the *Cook County National Bank* case that the statutes with respect to national banks require ratable distribution without regard to other statutory priorities or other equities has been consistently adhered to.

In *Texas & Pacific Railway Co.* v. *Pottorff*, 291 U.S. 245, 255, Justice Brandeis stated in the course of considering whether national banks had power to pledge their assets to secure a private deposit, that to permit such pledge "would be inconsistent with many provisions of the National Bank Act which are designed to insure, in the case of disaster uniformity in the treatment of depositors and a ratable distribution of assets."

Even apart from the *mandatory* ratable distribution requirement of 12 U.S.C. 194 (contrary to all equity principles of receivership and reorganization), the three cases cited by the Solicitor General do not support the proposition that claims of defrauded stockholders who rescind their open market stock purchases against the debtor are entitled to rank on a parity with other unsecured ~~stock-holders~~ CREDI[illegible]. In each of the cases the defrauded stockholder dealt directly with the bank or its officials.

In *Clark* v. *Boston-Continental National Bank*, 84 F.2d 605, 607 (C.A. 1, 1936) plaintiffs were induced by the fraud of the president of the national bank to make loans to certain stockholders upon the security of their shares of stock. The bank closed forever sometime after the loans. The issue in the case was:

> "whether . . . the plaintiff, as judgment creditors of an insolvent bank, having paid the assess-

ments levied against them as stockholders, may participate ratably with other creditors in a distribution of the assets of the bank in the hands of the receiver."

The court held that the plaintiff should participate ratably with other creditors.

In *Salter* v. *Williams*, 244 Fed. 126 (C.A. 3, 1917) again the national bank made false representations to Salter to induce him to purchase stock *owned by a borrower* from that bank in order to reduce that borrower's indebtedness. In order to effect the purchase by Salter, the national bank made a loan to him. Upon the bank's failure, Salter met his liability as a shareholder by paying his statutory assessment. The court correctly reasoned that to deny Salter his right of rescission would result in a curious oversubscription of the bank's capital. That is to say, the creditors of the bank would have received the benefit of the purchase price of the shares in question on original issue, the benefit of the assessment paid by Salter as a stockholder and the amount paid by Salter to the bank for the stock in order to effect the reduction of a borrower's loan from the bank.

It is only in *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206, that the actual question is presented as to rescission by a shareholder of a purchase from a national bank of its stock induced by fraudulent representations made by its officers. The crux of Mr. Justice Butler's decision is that "discrimination against their claims is not authorized by statute" and the statute to which he was referring was 12 U.S.C. Sec. 194 which es-

chews all principles of legal and equitable priority. As in the other cases, the stockholder had paid his assessment and this court held that his judgment for damages upon his rescission of the sale of the stock was entitled to rank on a parity with other unsecured creditor's claims.

Other than these National Bank cases, we find it uniformly held that stockholder rescission claims, even where corporate fraud exists are subordinated to the rights of creditors.

In cases involving insolvent *state* banks (the rigidity of the National Bank Act being inapplicable), stockholders who had been induced to purchase stock by false representations are subordinated to the rights of depositors and other innocent general creditors. See, *e.g.*, *Green* v. *Stone*, 205 Ala. 381, 87 So. 862 (1921); *Davis* v. *Burns*, 173 S.W. 476 (C. App. Tex. 1915); *Burleson* v. *Davis*, 141 S.W. 559 (C. App. Tex. 1911).

Rescission claims by stockholders have been subordinated to creditor claims in bankruptcy proceedings:

> "The law of the domicile of this bankrupt corporation in which appellant is a stockholder, and the great weight of authority, are that, given a corporation insolvent and unpaid subscriptions, corporate fraud inducing the subscriptions affords no stockholder a defense to collection, or ground for rescission, or basis for trust or lien, to the prejudice of corporate creditors. A fortiori, nor in respect to stock subscriptions paid." (Citing other cases)

* * * * *

> "However ignorant appellant of corporate insolvency and transactions, he knew the corporation was engaged in business, and might, as it did, incur debts. Hence he was charged with notice and knowledge of corporate status and acts, so far as creditors were concerned. That no creditors knew he was a stockholder is immaterial. Credit is given to corporations, with little or no knowledge of names of stockholders, but with confidence that, whoever they are, their rights in and to corporate property are subordinate to the rights of creditors."
> *In re Irving Whitehouse Co.*, 293 Fed. 287 (C.A. 9, 1923).

It is apparent from the authorities cited that if stockholder rescission claims were to be allowed, the court would have to classify them as inferior to the claims of general creditors under the broad and equitable classification powers provided in Section 197 of the Bankruptcy Act.

It is inequitable to allow parity treatment of stockholders' rescission claims because the claimants bargained for equity-type profits and assumed equity-type risks. In contrast, orthodox creditors dealt with the corporation with the expectation that they would have a senior position as against its assets to that of stockholders. They bargained for debt-type profits and certainty of payment.

This basic difference exists even where a corporate management has been guilty of the grossest fraud. When (as here) both creditors and stock purchasers have been defrauded, the equities obviously favor the former over the latter. A defrauded stock purchaser always has an option

to ratify his purchase and thus is able to straddle the future prospects of the manipulated company. If things go well, he shall be a stockholder, and if things go poorly, he shall be a creditor. This straddle is inequitable at least vis-a-vis unsatisfied creditors.

The history of the Stockholders Committee in this proceeding shows the most flagrant straddling. Initially it claimed that the debtor might be solvent (I 128-134) but at least as early as July 1, 1960, when the Report of Investigation was filed, it had knowledge that the market had been flooded with stock that should not have been resold. Thereafter, for nearly 2 years the Committee failed to file a single rescission claim, nor did any stockholder file a claim. It was only *after* the valuation hearings were concluded, and it was apparent that the debtor was hopelessly insolvent, that the Stockholders Committee filed a claim on behalf of a stockholder. That stockholder, Irma S. Mason, is the wife of Malcolm S. Mason, one of the attorneys for the Stockholders Committee and is herself an attorney.

No other stockholder has come forward with a claim in all the years involved in this reorganization. The Solicitor General speaks of the Trustee having ignored the claims of stockholders, while actually there were none to be ignored other than Mrs. Mason's. He suggests on page 20 of his brief that the Trustee should "have devised a procedure pursuant to Section 196 to determine the legal questions before formal proofs of claims would have had to be filed." We suggest that it would be the duty of the Stockholders Committee to suggest some "procedure" *after* it had found some stockholders who wanted to assert

claims. Apparently the Solicitor General wants the Trustee and the court to *invite* the filing of claims by stockholders.

Mrs. Mason is estopped to assert that her claim is timely filed because she is the attorney-wife of counsel of record for the Stockholders Committee. As to the class claim filed on behalf of all "non-management stockholders", we can find no provision in the Bankruptcy Act for the filing of such a claim for unknown claimants in unknown amounts. Section 209 authorizes any creditor or stockholder to be represented by a committee, but Sections 210 and 211 (4) require the filing of names and addresses and a statement showing the claims or stock represented.

All of these circumstances led the district court to the conclusion that the Stockholder Committee claims were, in effect, not filed in good faith and were too vague, indefinite and nebulous to warrant serious consideration and further delay in approving a plan of reorganization.

THE CONTENTION THAT COMPROMISES OF MAJOR CLAIMS WERE IMPROPERLY APPROVED BY THE COURT.

We have outlined in our Brief in Opposition to the Petition herein the numerous hearings held by the district court when the plan of reorganization was being considered. Among the matters thoroughly considered by all parties and the court were the compromises of the Merrill-Stevens and Caplan mortgage claims. It is true that the Trustee filed objections to these claims and, together with his counsel, examined a mass of evidentiary matter that led to the filing of the objections. It is quite another matter, however, to decide whether to litigate complicated and

contested issues when there is the responsibility to formulate a plan of reorganization and conclude the expensive litigation that has prolonged these proceedings and has been a heavy burden on the debtor.

The provisions in the reorganization plan for the compromise of these claims were arrived at after intensive investigation and a prudent evaluation of the results and of the law, and reflect a fair adjustment of the equities. The district court's findings stated:

> "While the vessel valuation proceedings were in progress and before any of the lien adjudication and marshalling proceedings had begun, the trustee and the unsecured creditors committee appointed by the court to represent that class of creditors were given informal permission by the court to contact the principal lien and priority claimants for the purpose of attempting to compromise and settle the issue involving such claims. This was deemed wise because it was apparent that the liquidation of the issues involved, particularly the objections to the Caplan and Merrill-Stevens claims, would take possibly years to conclude and it was the opinion of the court as well as the trustee and the creditors committee that the financial success of the trusteeship required the early reorganization of the debtor if at all possible.
>
> Negotiations by the trustee and the creditors committee resulted in proposed compromises of the Caplan mortgage claim and the Merrill-Stevens claims, which compromises are included

in the Internal Plan of Reorganization, initially filed by the creditors committee. It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders Committee is too remote for serious consideration. If the unsecured creditors approve the Internal Plan with these compromises, the only class that can object are the stockholders, and the court has found in the Valuation and Insolvency Order that the stockholders have no equity even if these two claims were disallowed in toto. The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act. (II 372-373)

With respect to the Merrill-Stevens claim and the proceedings and investigations which took place prior to the court's findings quoted above, we include as an appendix hereto portions of the Trustee's MOTION FOR ALLOWANCE OF CLAIM which outline the background of the settlement. A hearing was held on this motion (II 35-40) at which objections were heard, and thereafter the nego-

tiations took place which resulted in the compromise. We can do no more than repeat here what we told the district court when the issue was heard (II 35-36), namely that the factual data which we studied with respect to the claim led us to the conclusion that the possibility was remote of obtaining any material reduction in the amount of the claim by litigating the objections, and that any such litigation would be time consuming and expensive to the debtor and would result in unnecessary delay in forming the plan of reorganization.

About three years later the Stockholders Committee asserted that it had uncovered more facts concerning the Merrill-Stevens claim (III 16-20) and these facts were considered by us in the light of our previous investigation. After hearing, the court rejected the effort to reopen the matter. (III 73-74)

Regarding the Caplan mortgage claim, the facts were fully developed in the Trustee's investigation in 1960. (II 597-615) The settlement reduced the claim from the face amount of $330,000 plus interest, costs and attorneys fees to $250,000 plus an interest item to be paid in the new common stock of the reorganized company. Again, it was our opinion that this was a fair compromise under the circumstances and we recommended its approval.

The approval of a compromise is an exercise of judicial discretion, which should not be disturbed unless the court acted arbitrarily or clearly abused its discretion. *Daniel Hamm Drayage Co.* v. *Willson*, 178 F.2d 633, 635 (C.A.8, 1949); *In re Prudence Co., Inc.*, 98 F.2d 559, (C.A. 2, 1938) *cert. denied sub. nom. Stein* v. *McGrath*, 306 U.S.

636; *In re Kalamazoo Building Co.*, 21 F.Supp. 852 (D.C. Mich. 1937).

The cases cited by the Solicitor General in support of his contention that the district judge did not have sufficient information before him to make "an informed independent judgment" on the compromises involved situations materially different from the case here. *National Surety Co.* v. *Coriell*, 289 U.S. 426, concerned approval of a *plan of reorganization* in which there was no valuation of the assets, no dependable schedule of liabilities, no evidence that a majority of the unsecured creditors favored the plan with respect to which "The receiver submitted no facts and made no recommendations." *National Surety Co., supra* at 435. *Ashbach* v. *Kirtley* 289 F.2d 159 (C.A.8, 1961) involved a $521,000 *judgment* settled for $105,000 which the appellate court reversed because of "the paucity of information furnished to the court by the trustee and his counsel." We have shown above that the district court had a great deal of information before it regarding the nature and background of the Merrill-Stevens and Caplan mortgage claims.

The case of *In re Chicago Rapid Transit*, 196 F.2d 484 (C.A. 7, 1952) set aside a settlement requiring *payment by the debtor* of $1,125,000 in compromise of certain claims "solely on the basis of expediency" where only 40% of security holders concerned favored the settlement and 11% opposed it. The court stated principles to be followed in approving settlements that are applicable to our situation:

> "And even in bankruptcy matters, which often involve many diverse interests, where any reason-

> able basis for compromise settlements appears they should be encouraged, and the bankruptcy court has broad discretion to approve them. It may be that acceptance by a large majority of creditors and opposition by an inconsequential number or amount would of itself constitute a reasonable basis for approval by the court without consideration of the merits of the claim or claims thus disposed of."
> *In re Chicago Rapid Transit*, supra, p. 490.

No creditor objected to the two compromises here and the plan of reorganization incorporating the settlements was accepted by overwhelming vote of the creditors in 1962 (II 387.8) and again in 1965. (III 325)

The creditors, of course, were the only parties concerned in the compromises since the debtor was insolvent and the stockholders had no equity. If the two compromised claims had been disallowed *in toto*, the debtor would have remained insolvent. Under all of these facts and circumstances it cannot be said that the lower courts acted arbitrarily or abused their discretion in approving the compromises.

THE DEBTOR IS INSOLVENT AND THE STOCKHOLDERS MUST BE EXCLUDED FROM PARTICIPATION.

The Solicitor General ignores the abundance of valuation evidence, as outlined in our initial brief, and contends that the district court applied "an erroneous method of valuation." The court thoroughly considered all of the evidence and made the going concern valuation by capital-

izing the peak earnings under the trusteeship. (II 387.5-387.7) Future earnings after reorganization and under anticipated different operating methods were not estimated because they would be entirely speculative and uncertain.

The Trustee testified that ". . . there are too many unknown factors. I could not possibly make a prediction." (II 108) The court said it ". . . will not attempt to guess what future management might do with the company after reorganization." (II 387.7)

After the 1962 valuation finding the earnings of the debtor declined, and based upon additional evidence taken in 1965 (III 120-212, 75-82) the court reaffirmed its finding of insolvency. (II 266-268)

Nothing will be found in the district judge's decisions inconsistent with this court's opinions in *Consolidated Rock Products, Inc.* v. *DuBois*, 312 U.S. 510 or *Institutional Investors* v. *Chicago, M. St. P.&P.*, 318 U.S. 523. The appellate court held that the district judge did not abuse his discretion and that his findings were not clearly erroneous.

CONCLUSION

It should be apparent that this case does not involve any novel questions of law or application of any erroneous legal principles requiring review by this court. It concerns issues of fact, contested through many years in the lower courts.

This court has stated that it should not be invited ". . . to reach conclusions from the voluminous record in

the case, contrary to those reached by the two courts below" such findings being "final here in the absence of very exceptional showing of error." *Comstock* v. *Institutional Investors*, 335 U.S. 211, 213-214.

We respectfully submit that no error has been shown and that the petition for a writ of certiorari should be denied.

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APPENDIX
PORTIONS OF TRUSTEE'S MOTION FOR ALLOWANCE OF CLAIM
Filed December 27, 1961
(II 23-26)

4. The trustee filed perfunctory objections to the Merrill-Stevens claim and all objections to claims were referred by court order dated January 13, 1959, to L. Earl Curry, Referee in Bankruptcy as Special Master. At the master's hearing on February 3, 1959, the only action with respect to the Merrill-Stevens claim was announcement by counsel for the trustee that the claim had been "accepted and settled out of court." That satement had reference to a decision by the trustee that the claim should be allowed in the amounts set forth in paragraph 3 above, following an examination of the debtor's records which indicated that work had been performed on the vessels as indicated in the claim, that no payments had been made thereon other than those reflected in the figures shown, and that no defenses to the claim were apparent. The master's report filed June 18, 1959 reported only that the claim had been "Settled." No exceptions were filed to said master's report with respect to the Merrill-Stevens claim.

5. The trustee filed on January 16, 1961 his PETITION FOR APPOINMENT OF SPECIAL MASTER for the purpose of marshalling all lien claims against the vessels, establishing priorities, and considering objections that had been filed to certain of the lien claims. That Petition contained the statement that the Merrill-Stevens claim along with several others had been the subject of informal settlement understanding between the trustee and the claimants as to the amounts of the claims. The Securities and Exchange Commission filed a response to the said Petition of the trustee in which it was stated that the

Merrill-Stevens claim should be disallowed because the trustee had not conducted a sufficient investigation of the claim, and on information and belief that a partial payment had been made on the claim by issuance of common stock of the debtor, that the claim was excessive and that the services represented by the claim were not satisfactory. At the hearing held January 27, 1961 on the said trustee's Petition, the court allowed the Securities and Exchange Commission time within which to file detailed specifications of its objections and allowed the claimant Merrill-Stevens time within which to file a reply to such specifications. The court's ORDER APPOINTING SPECIAL MASTER dated February 6, 1961 required a determination of the liens and their respective priorities that should be allowed against the ships of the debtor, but made no specific reference to any objections to the Merrill-Stevens claim. The Special Master, E. A. Bosarge, has conducted no formal hearings on these issues and there has not been presented to him for consideration, any matters involving objections to the Merrill-Stevens claim.

6. Thereafter the Securities and Exchange Commission conducted an investigation of the Merrill-Stevens claim and specifications in support of its objections to the claim were filed herein on August 3, 1961, and thereafter Merrill-Stevens filed on September 1, 1961, its answer to such specifications.

7. Thereafter the trustee, with the assistance of attorneys in the office of his counsel, investigated the facts alleged in the specifications of objections filed by the SEC and in the answer of Merrill-Stevens. This investigation consisted of an examination of numerous documents assembled by the SEC during its investigation, together with copies of statements made by individuals

which had been obtained during the investigation. Also examined were numerous documents and statements furnished by Merrill-Stevens in support of its answer to the specifications of objections by the SEC.

8. Efforts have been made by the Trustee to effect a compromise with Merrill-Stevens of the amount of its claim in view of the objections filed against it, but Merrill-Stevens has refused to make any compromise and insists that its claim be allowed in full. It is the opinion of the Trustee and of his undersigned counsel that further effort to compromise or settle this claim will not be successful.

9. Two attorneys in the office of counsel for the trustee have examined the factual data gathered in the trustee's investigation of the objections to the Merrill-Stevens claim and it is the considered opinion of both attorneys that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it. Trial of the issues raised by the objections would be time consuming and would result in unnecessary delay in formulating a plan or (sic) reorganization. It is the opinion of the trustee and his undersigned counsel that the Merrill-Stevens claim should be allowed in the amounts specified in paragraph three (3) above and that the pending proceedings before the Special Master, E. A. Bosarge, for the marshalling of the liens against the vessels should be limited to a determination, insofar as the Merrill-Stevens claim is concerned, of the relative rank and priority of that claim with the other claims filed against the vessels named.

WHEREFORE the trustee prays for the entry of an Order allowing the claim of Merrill-Stevens in the amounts specified in paragraph three (3) above.

SUPREME COURT, U. S.
FILED
SEP 7 1967
JOHN F. DAVIS, CLERK

No. 88

In the Supreme Court of the United States

OCTOBER TERM, 1967

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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6 Collier, *Bankruptcy*, ¶ 7.08 (14 ed. 1965) 26, 35
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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC., PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION[1]

OPINIONS BELOW

The opinions of the district court (II 370, 387, 881; III 260, 3[illegible], 387, 389)[2] are unreported. The opinions of the court of appeals (Pet. App. 3a, 6a) are reported at 334 F. 2d 118 and 364 F. 2d 936.

[1] The Securities and Exchange Commission participated as a party in this case in both the district court and the court of appeals (see *infra*, pp. 4–5), and thus is a respondent before this Court, although not named as such in the caption.

[2] We shall use the same form of record references that the petitioner uses, *i.e.*, the records in the three appeals to the court of appeals will be cited as "I", "II", and "III", respectively (see Petition, n. 1, p. 2). "Pet. App." refers to the Appendix to the Petition.

JURISDICTION

The judgment of the court of appeals was entered on August 12, 1966 (III 563). On November 8, 1966, Mr. Justice Black extended the time for filing a petition for a writ of certiorari to and including January 9, 1967. The petition was filed on the latter date, and was granted on May 29, 1967 (III 565; 387 U.S. 929). The jurisdiction of the Court rests on 28 U.S.C. 1254(1), and 11 U.S.C. 47c, 521.

QUESTIONS PRESENTED

The Securities and Exchange Commission will discuss the following questions in this brief:

1. Whether under Chapter X of the Bankruptcy Act, which provides for a disinterested trustee as the focal point of the reorganization, the trustee is precluded from assuming the presidency of the reorganized company; and whether a plan that contemplates that result may be confirmed.

2. Whether the district court erred in approving compromises of substantial claims against the debtor that were seriously disputed, when the record did not permit an adequate evaluation of the claims or disclose the basis for their settlement.

3. Whether, in approving as fair and equitable a plan of reorganization under which stockholders are excluded from participation because the debtor has been found insolvent, the method which the district court used in valuing the debtor was erroneous because it did not consider the future estimated earnings of the reorganized company.

4. Whether the courts below erred in refusing to

consider the merits of the stockholders' claims based on asserted violations of the securities laws.

5. Whether the district court erred in discharging the Stockholders Committee before the reorganization proceedings were completed, on the basis of its finding that the debtor was insolvent.

STATUTE INVOLVED

Many sections of Chapter X of the Bankruptcy Act (11 U.S.C. 501 *et seq.*) are involved; the following sections are particularly pertinent:

Section 156 (11 U.S.C. 556):

> Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested * * *. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Section 158 (11 U.S.C. 558):

> A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—
>
> (1) he is a creditor or stockholder of the debtor; or
>
> (2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Section 221 (11 U.S.C. 621):

The judge shall confirm a plan if satisfied that—

* * * * *

(2) the plan is fair and equitable, and feasible;

* * * * *

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy.

STATEMENT

This case involves the reorganization of TMT Trailer Ferry, Inc. ("the debtor") under Chapter X of the Bankruptcy Act. Pursuant to Section 208 of that Chapter (11 U.S.C. 608),[3] the Commission has

[3] In Title 11 of the United States Code the numbers of the sections of the Bankruptcy Act comprising Chapter X are

been participating as a party since the inception of the reorganization proceeding, and for the most part has taken positions in the courts below consistent with the positions of the petitioner Stockholders Committee.[4]

1. HISTORY OF THE PROCEEDINGS

The debtor, incorporated in 1954, is engaged in the business of transporting loaded truck trailers and other freight on sea-going vessels between Florida and Puerto Rico. Between 1954 and 1957, it issued more than 4,000,000 shares of its common stock at prices ranging from $1 to $2.50 per share. Approximately one-half of these shares were acquired by insiders who resold the stock to public investors for various prices up to $4 a share. (II 584–589, 608–612.) Almost none of the shares sold to the public had been registered under the Securities Act of 1933 (15 U.S.C. 77a) (II 584–585).

The reorganization proceeding was initiated by an involuntary petition filed against the debtor in June, 1957, in the United States District Court for the Southern District of Florida. The court appointed the respondent C. Gordon Anderson as trustee. At that time more than 7,000 investors owned stock of the debtor (II 579–580). The district court, with the approval of the court of appeals, has confirmed a plan of reorganization under which these stockhold-

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higher by 400 than in the Act itself, *i.e.*, Section 208 of that Act is Section 608 of Title 11. We shall use the Bankruptcy Act rather than the Code section numbers.

[4] In response to an invitation by the Court for the United States to express its views at the petition stage (386 U.S. 901), the Commission filed a memorandum supporting the petition.

ers are excluded from participation in the reorganized corporation on the grounds (1) that the debtor is insolvent and (2) that their claims against the debtor based upon violations of the federal securities laws—violations, which, they alleged, entitled them to participate in any plan of reorganization as general creditors—were untimely made. 364 F. 2d 936.

Early in 1959 the district court had confirmed a plan of reorganization recommended by the trustee which would have given control of the corporation to the holders of preferred ship mortgages on the debtor's vessels ("the Caplan mortgage")[5] (II 473, 580), even though the court had questioned (I 29) and the trustee had objected to (I 34) the validity of their claims. At that time Anderson resigned as trustee to become president of the reorganized debtor (I 38, II 525) and a successor trustee was appointed (I 38). Shortly thereafter, the successor trustee petitioned, in effect, to vacate the order confirming the plan. He alleged that the holders of the Caplan mortgage and Merrill-Stevens Dry Dock & Repair Co. ("Merrill-Stevens"), also a substantial creditor, had entered into an agreement prior to acceptance of the plan which violated Section 221 of Chapter X, *i.e.*, an agreement by which the Caplan mortgage group would pay Merrill-Stevens in order to procure its acceptance of the plan (I 39–40). The successor trustee's petition, which the Commission supported (I 222), was denied,

[5] In the Petition these persons sometimes are called the Shaffer-Spitzer group (II 597–599). Shaffer and Spitzer succeeded Caplan as trustee under the preferred ship mortgage indenture.

the successor trustee was removed and Anderson was reinstated as trustee (I 38–41).

The Stockholders Committee appealed from the order of confirmation. The "appeal was predicated on the failure of the trial court to order the trustee to conduct an investigation * * * and on a failure of the court to conduct a hearing on insolvency of the debtor and to make findings of its assets and prospective earnings" (*TMT Trailer Ferry, Inc.* v. *Anderson,* 292 F. 2d 455, 457 (C.A. 5), certiorari denied *sub nom. Shaffer* v. *Anderson,* 368 U.S. 956). While that appeal was pending and after Caplan had filed "a petition for leave to consummate the plan," which Anderson supported, the Commission filed in the district court a petition for an investigation. The Commission asserted that "an investigation would disclose that the reorganization plan would be unfair in turning the corporation over to persons, or close associates of persons, who had dealt extensively in the stock of the company in transactions which * * * were of questionable legality" (*ibid.*). At a hearing on objections to consummation, all the parties agreed that an investigation should be made (*ibid.*).

Respondent Anderson, who, as noted above, had been reinstated as trustee (I 41), conducted the investigation. On July 1, 1960, he filed a lengthy report, in which he concluded that the debtor's business had been "wrecked by gross mismanagement, by unwise and unsound expansion financed primarily through the sale of securities in disregard of the protective provisions of the Securities Act of 1933" (II 584), and that the debtor had claims against holders of the Cap-

lan mortgage based on such mismanagement (II 606, 609, 614). The trustee recommended that the order confirming the 1959 plan be vacated (I 294). The district court vacated the order, and the court of appeals affirmed. *TMT Trailer Ferry, Inc.* v. *Anderson, supra.*

Early in 1962, two new plans of reorganization were proposed (II 41, 637). One plan, recommended by the trustee and known as the "internal plan," provided for reorganization of the debtor by the issuance of new common stock to its creditors, and had attached a proposed contract whereby the trustee would become president of the reorganized company (II 296–299, 695, 707). This plan, stated to be "Suggested by Certain Major Creditors" (II 41, 691), provided for "compromises" of the Caplan mortgage and the Merrill-Stevens claims almost in full, as more fully discussed *infra,* pp. 12–15 (II 41.5–41.6). Under the plan Merrill Stevens, in conjunction with the trustee and his general manager, would have gained initial control of the reorganized company.[6] The other plan, opposed by the trustee and known as the "cash plan," provided for the sale of the debtor's assets for cash to persons unconnected with the company, and the distribution of the cash to the creditors (II 711). The cash plan also provided for "compromises" of the Caplan and Merrill-Stevens claims (II 715). Neither plan provided for any participation by the stockholders.

[6] Under the formula outlined in the plan, Merrill-Stevens, because of the amount of its claims, nominated two of the seven directors of the reorganized company (II 348, 702, 706, III 353). Anderson and his general manager, B. E. Thouvenelle, were appointed directors by the court (II 987).

The Stockholders Committee, supported by the Commission, objected to both plans on the ground that the stockholders were improperly excluded and further objected to the internal plan because it (like the earlier plan) contemplated employing the trustee as president of the reorganized company (II 1086, 1087, 1089). After hearings on valuation, the district court found that the debtor was insolvent, and approved both plans as fair and equitable and feasible (II 380, 387.5–387.8).[7]

A majority of all classes of creditors (other than the United States, which had non-tax claims exceeding $900,000) accepted the internal plan (II 388). No acceptances were solicited from stockholders. In February 1963, the district court confirmed the plan (II 881).

In an appeal from that order of confirmation, the Stockholders Committee, supported by the Commission, contended that the plan was objectionable because it improperly excluded stockholders and contemplated that the trustee would serve as president of the reorganized company. The court of appeals, without reaching the other issues, held that the latter fact did not invalidate the plan.[8] In a separate appeal

[7] The internal plan had been amended prior to this time to eliminate the proposed contract for the trustee's employment as president of the reorganized company, but the plan did provide "that competent management, which might include present management," was to be employed. The order confirming the plan noted that the "identity, qualifications, and affiliations of the persons * * * to be directors and officers * * * upon the consummation of the * * * plan" had "been fully disclosed" (II 886; Pet. App. 4a).

[8] *Protective Committee, Etc.* v. *Anderson*, 334 F. 2d 118.

by the United States, however, the court held that the plan was defective because it failed to accord priority to the government's non-tax claims, and remanded the proceeding to the district court to determine whether the plan would be feasible with a provision for such treatment.[9]

On remand the district court ruled that the decisions of the court of appeals left open for it to determine only whether the plan would be feasible if the government's non-tax claims were given priority; it viewed the court of appeals' failure to reverse its rulings, such as that the stockholders had no interest in the reorganized company, as, in effect, an affirmance of those rulings (III 264).[10] After further hearings, the district court authorized amendments to the plan primarily to provide for the immediate cash payment of the United States' claims (III 71–73). The Commission, in its advisory report on the amended plan, stated that the plan appeared to be feasible but that it was not fair and equitable because it excluded the stockholders from participation in the reorganized company (III 235–239). The creditors accepted the amended plan (III 316, 325) and, over objections by the Committee (III 336) and the Commission (III 325), the district court confirmed it (III 328). For a third time the Stockholders Com-

[9] *United States v. Anderson*, 334 F. 2d 111, certiorari denied, 379 U.S. 879.

[10] The court of appeals subsequently held that the district court had misinterpreted the scope of those prior decisions, since the "reversal of the order of confirmation left open those issues not in terms discussed and decided." 364 F. 2d at 939.

mittee appealed from the order of confirmation, and the Commission supported its appeal.

2. SUMMARY OF THE AMENDED PLAN

The amended plan, as confirmed, provides for full payment in cash of costs and expenses of administration, of tax claims, of the non-tax claims of the United States, and of substantially all secured claims of less than $500. Secured creditors holding claims of more than that amount, except for the two such claims discussed *infra*, pp. 12–15, are given the choice of being paid in full over a five-year period or of participating as unsecured creditors. The latter are to receive *pro rata* a total of 1,300,000 shares of new common stock of the reorganized company (III 250–253).

No participation is provided for the stockholders, either as stockholders (since the plan states that the debtor is insolvent (III 253)), or pursuant to their claims arising from alleged violations of the federal securities laws (see pp. 15–16, 56–58, *infra*).

Respondent notes (Reply to the Commission's Memorandum in support of the Petition for a writ of certiorari, p. 4), that pursuant to this plan the directors of the reorganized company "have taken over the assets of the debtor and are running its business."[10a] The directors include respondent (III 393), who, we are advised, has become president of the reorganized company.

[10a] Each stock certificate of the reorganized company issued pursuant to the plan is required to bear a notation referring to the pending appeals (order entered Sept. 27, 1965).

3. THE CONTESTED CLAIMS

a. THE CLAIM OF THE HOLDERS OF THE CAPLAN MORTGAGE

The principal holders of the Caplan mortgage claim—the face amount of which was $330,000—were Joseph Abrams, Arthur Shaffer, and Robert Erdman (II 598–599). The trustee's report detailed the manner in which Shaffer and Abrams, sometimes with Erdman, caused the debtor to issue to them (or their nominees) in various transactions between December 1955 and June 1957 and at prices substantially below the market, a total of 1,825,500 shares of stock of the debtor. They resold these shares, without registration, to the investing public at large profits to themselves (II 605, 609–612). For example, according to the report, Abrams caused the debtor to exchange 385,000 shares of its stock for stock of another corporation he controlled; that corporation pledged the debtor's stock to a bank as collateral for a loan; when that corporation defaulted on the loan, the bank sold the stock to a syndicate headed by Abrams at two-thirds of its market price; the syndicate then sold the stock to the public (II 588). In another transaction characterized in the report as "fraudulent" (II 614), the debtor issued stock to a corporation in which Abrams had a substantial interest, in return for property of that corporation, on the basis of an "appraisal" of such property which far exceeded its value. This stock also was sold by that corporation through Abrams to the public (II 590–594, 611). The report also stated that during the periods when Abrams, Shaffer and Erdman were selling the debtor's stock to public investors, the debtor was caused to con-

duct a publicity campaign intended to create a speculative market in that stock (II 595).

The trustee concluded that Abrams, Shaffer and Erdman appeared to have violated the federal securities laws (II 612); that the debtor had defenses to the claims of the holders of the Caplan mortgage (II 606); and that the debtor had causes of action against Abrams, Shaffer and Erdman (II 609). He also concluded that the claims based on the Caplan mortgage should be subordinated to claims of innocent parties (II 614), and that Abrams, Shaffer and Erdman should be required to account for the profits they made through taking personal advantage of corporate opportunities (II 612–613).

After the trustee had filed his report of investigation and the district court had vacated its order confirming the 1959 plan (*supra*, pp. 7–8), both the trustee and the Commission filed objections to the Caplan mortgage claim (II 1093, 1096). The district court held no hearing on these objections. The plan that the court ultimately approved and confirmed, however, provided for a "compromise" under which $280,500 (the actual amount paid for the mortgage) was to be paid in cash in five annual installments;[11] and interest on that amount was to be allowed from January 1958 (the original due date), but was to be treated as an unsecured claim payable in stock (III 272).

[11] The plan was later amended to provide for the immediate payment of $250,000 in cash at the time of consummation, instead of $280,500 over five years (order entered September 21, 1965).

b. THE MERRILL-STEVENS CLAIMS

Merrill-Stevens filed claims totalling $1,628,284, of which $574,580 allegedly was secured by maritime liens on certain of the debtor's vessels (II 23). More than $1,000,000 of these claims was for the unpaid balance of Merrill-Stevens' charges for the conversion of one of the debtor's vessels (the Carib Queen) from a partially-completed naval ship into a self-propelled trailership. On its maiden voyage a series of boiler failures caused a breakdown of the vessel, necessitating extensive repairs (II 596, 1099–1100).

In 1961, the Commission, after an investigation, filed objections to these claims, urged that the trustee should investigate them, and suggested that they should be referred to a special master for hearing (II 1093)—because it appeared that the boiler failures resulted from Merrill-Stevens' negligence in performing its work of converting the vessel, and that the debtor therefore might be able to offset against the claims the expenses of repairing the vessel (III 405).

Although the trustee initially sought a reference to a special master for a hearing on the Merrill-Stevens claims (II 862), no such hearing was held. Instead, the trustee subsequently moved for the summary allowance of the claims on the ground that there was only a "remote" possibility of materially reducing them by litigating the objections filed against them (II 22). The Stockholders Committee, supported by the Commission (II 37, 1042, 1073), the Department of Justice (II 647) and the Caplan mortgage group

(II 636), filed objections. Despite these objections the plan ultimately approved and confirmed allowed these claims in full as unsecured claims (II 702). Merrill-Stevens received about 40 percent of the common stock of the reorganized company (III 251–252, 282).

C. THE STOCKHOLDERS' CLAIMS BASED ON ALLEGED VIOLATIONS OF THE FEDERAL SECURITIES LAWS

Based substantially on the facts in the trustee's report of investigation, the Stockholders Committee repeatedly asserted in various ways that non-management stockholders had claims against the debtor arising out of violations of the federal securities laws committed by the debtor acting in concert with Abrams, Shaffer and Erdman (see *supra*, pp. 12–13); and that such claims were entitled to be treated as claims of general unsecured creditors, irrespective of the solvency or insolvency of the debtor. The Stockholders Committee made this contention to the district court in connection with the formulation, approval and confirmation of the plants of reorganization (II 363, 364–368, 962, 1037, 1074, 1083, 1086–1088; see below, pp. 56–60.

The district court, without any hearing, denied these claims, stating:

> There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from the debtor * * * and the time for filing claims expired several years ago. * * *
>
> Furthermore, the [Committee's] claim is filed

too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage. [II 379–380; emphasis in original.]

4. THE DISTRICT COURT'S DISCHARGE OF THE STOCKHOLDERS COMMITTEE

The district court on May 21, 1965, about a month after it confirmed the amended plan, entered an order discharging the Stockholders Committee "as representatives of stockholders as a class in these proceedings" (III 387). The order recites that, since the court has found the debtor to be insolvent and has confirmed a plan which eliminates all equity of stockholders, "no further services are required of the Stockholders' Committee" (III 388) and that "no useful purpose * * * will be served by continuing to recognize the Committee as a party to these proceedings" (III 389).[12] The discharge order also recites that the Committee had attempted to "litigate issues which have been determined by * * * [the district] court adversely to the Committee's contentions * * * [and] are not in issue before the court * * *" (III 388–389); that reference apparently was to issues the court of appeals later said it had left undecided (*ibid.*; see *supra*, p. 10, n. 10).

5. THE DECISION OF THE COURT OF APPEALS

Stating that "[t]his nine-year-old litigation must at long last be brought to an end," the court of appeals affirmed the orders, *inter alia*, confirming the plan

[12] The Committee has been permitted to prosecute the present appeals (III 389), which include an appeal from the order discharging it.

and discharging the Stockholders Committee. It held (1) that the district court had not abused its discretion in refusing, without a hearing, to consider the stockholders' claims on their merits and (2) that the district court's finding of insolvency was not clearly erroneous. 364 F. 2d 936, 940, 941.

SUMMARY OF ARGUMENT

I

One of the major reforms for corporate reorganizations provided by Chapter X is the requirement that a trustee be "disinterested." The necessity for that neutral quality stems from the role Congress established for the trustee, who is to be the focal point of the reorganization process. While it is the court which is charged with final responsibility over all phases of the reorganization, it is the trustee who conducts the necessary investigation into the debtor's financial condition and who evaluates competing claims to the debtor's assets. He is charged, among other things, with the primary responsibility for drafting a plan of reorganization, and it is through him that the court is able to perform its functions under the Act.

The legislative history shows that Congress considered the requirement that the trustee be disinterested as the keystone of reform. The statute provides that certain circumstances negative disinterestedness, such as a creditor or stockholder relationship with the debtor, or "for any reason an interest materially adverse to the interests of any class of creditors or stockholders." The trustee's interest in future employment in a position of importance with the reorganized company, or the possibility thereof, is materially adverse to the inter-

ests of certain creditors and to the stockholders of the debtor, for, consciously or unconsciously, in areas of dispute, the trustee might lean to those solutions which might best enhance his own prospects. For the same reasons, the district court could not properly find, as Chapter X requires, that the appointment of the trustee as president "is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

To insure that a trustee be totally disinterested and that a plan of reorganization be free from any possibility of taint, the trustee should be disabled from becoming president of, or assuming some other position of importance with, the reorganized company.

II

The courts below improperly approved compromises of two seriously disputed claims against the debtor aggregating approximately $2,000,000. The record was not adequate to enable the courts to make the "informed, independent judgment" (*National Surety Co.* v. *Coriell,* 289 U.S. 426, 436) which is necessary before such compromises may be approved in a Chapter X reorganization proceeding. The record does not adequately disclose the grounds upon which the trustee determined to settle the claims on a basis which allowed them almost in full, or upon which the district court approved such settlement as "fair and equitable." The need for a fully informed judicial evaluation of the settlement is particularly important in view of the district court's holding that because of the debtor's insolvency stockholders are

not entitled to participate in the reorganized company. For if, as the record strongly suggests, both of these claims are subject to serious infirmities, then any fair settlement thereof would substantially reduce the creditors' claims allowable against the debtor and, in light of the district court's use of erroneous evaluation standards (see III below), could lead to a finding of solvency and participation in the estate by the stockholders. Moreover, careful scrutiny of the compromises was called for since one of the claimants thereby emerged with a substantial share of the new company and thus a major voice in the selection of its president—an office which that claimant and the trustee contemplated the latter would fill.

A. The trustee's report of investigation detailed how the principal holders of the Caplan mortgage claim had personally profited at the expense of the debtor and to the apparent detriment of the stockholders. Both the trustee and the Commission objected to these claims, but the court held no hearing thereon. Instead, it approved a settlement under which the claims were "compromised" for more than four-fifths of their principal amount, and the only explanation the trustee gave was that he, his attorney, and the attorney for the claimants "worked out" a mutually satisfactory agreement (II 284). The record does not provide any adequate basis for determining whether this settlement was fair.

B. There was similarly no hearing upon the serious and substantial objections made by the Commission and the Stockholders Committee to the bulk of the Merrill-Stevens claims of $1,600,000. The only con-

cession this claimant made under the compromise was accepting the reclassification of the allegedly secured portion of its claim—constituting approximately one-third of the total—as unsecured; there is serious question whether this portion of the claim was secured at all. Merrill-Stevens received approximately 40 percent of the stock of the reorganized company for its total claims. The record does not adequately explain the basis of settlement or the theory upon which the district court determined that contest of these claims was inappropriate.

III

The district court excluded the stockholders from participation because of its finding that the debtor was insolvent. If that determination was not made in accordance with the proper standards of valuation, however, the district court's confirmation of the plan as "fair and equitable" cannot stand. Those words incorporate the absolute priority doctrine under which junior interests cannot be excluded from participation if the value of the reorganized company exceeds the claims of the senior interests. The estimated future earnings of a debtor in reorganization are the primary basis for valuing it. *Consolidated Rock Products Co.* v. *DuBois,* 312 U.S. 510, 526. In valuing the debtor and finding it insolvent in the present case, the district court relied upon its past earnings record and failed to consider "all facts relevant to future earning capacity. * * * including * * * all circumstances which indicate whether or not * * * [the past earnings] record is a reliable criterion of future performance." *Consolidated Rock Products, supra.* The court refused to consider the future growth of the

debtor's business, which the record indicates was likely. Valuing the debtor on the basis of its existing operations, rather than upon an informed estimate of its future earnings when reorganized, may improperly reduce the valuation because of the inherent limitations of a business operated under court trusteeship.

Since the court's valuation rested upon an improper standard, the court of appeals erred in affirming the finding of insolvency as not "clearly erroneous."

IV

It was repeatedly contended on behalf of the debtor's non-management stockholders that the latter had been sold stock by persons in conspiracy with the debtor in violation of the federal securities laws, and that they had claims arising therefrom entitling them to participate under the plan as general creditors. Many of the facts giving rise to the alleged violations of the securities laws were first disclosed in the trustee's report filed in 1960, long after the 1958 bar date for proof of claims, yet the courts below held the stockholders' claims based on that information to be untimely, notwithstanding that no prejudice to any party had been demonstrated. Moreover, since the claims go to the very fairness of the plan itself, the equitable doctrine of laches should not, in any event, bar their consideration.

In alternatively denying the claims as without merit on their face—an issue the court of appeals did not reach—the district court failed to recognize that numerous courts have upheld private causes of action by persons damaged as a result of violations of the federal securities laws, even in the absence of contractual privity. A court with as broad equity powers

as a reorganization court possesses may not close its eyes to the contention that the claims of defrauded stockholders be given equality with, or priority over, the claims of creditors, some of whom, it is alleged, not only participated in the fraud upon those stockholders but also were responsible for the debtor's collapse.

V

The district court erred in discharging the Stockholders Committee on the basis of its finding that the debtor was insolvent, a finding that is a subject of this appeal. Chapter X makes no provision for the discharge of a committee upon a finding of insolvency, and the value of a debtor may sufficiently increase during the reorganization as to require reconsideration of that finding. The statutory purpose of protecting public investors through participation in reorganization proceedings by committees would be defeated if such committees were not permitted to remain in the proceeding until it is finally terminated.

ARGUMENT

I. CHAPTER X OF THE BANKRUPTCY ACT PRECLUDES A REORGANIZATION TRUSTEE FROM BECOMING THE PRESIDENT OF THE REORGANIZED COMPANY; A PLAN THAT SO PROVIDES OR CONTEMPLATES CANNOT BE CONFIRMED [13]

A. THE LEGISLATIVE HISTORY AND STATUTORY SCHEME OF CHAPTER X DICTATE THAT A TRUSTEE BE TRULY DISINTERESTED

One of the major reforms for corporate reorganiza-

[13] Respondent contended in its Reply (pp. 5-7) to our Memorandum in support of the Petition that this issue was not properly before the Court, having been decided by the

tions provided by Chapter X was the requirement in Section 156 that "[a]ny trustee appointed under this chapter shall be disinterested * * *." This requirement was designed to eliminate past reorganization abuses that had resulted from "friendly" trustees.[14] It is clear that Congress contemplated that the disinterested trustee would do more than operate the debtor's business; he was to be the "focal point" for the reorganization.[15] Indeed, in recommending the legislation the Commission informed Congress that "* * * the independent trustee is the key to real reform. In comparison, the other reforms are secondary."[16]

A brief examination of the trustee's duties will illustrate the reason for Congress' concern that he be disinterested. Section 167 of Chapter X provides that the trustee is to report on the desirability of the continuance of the debtor's business; he is charged with conducting any investigation that may be necessary, not only with respect to the debtor's financial condition and its business operations, but also as to any fraud,

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court below on a previous appeal in this case. Plainly, however, the issue is properly presented here. See, *e.g.*, *Mercer* v. *Theriot*, 377 U.S. 152; *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 257–258.

[14] S. Rep. No. 1916, 75th Cong., 3d Sess. 21, 27 (1938). See generally, Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees*, Parts I and II (1937).

[15] H. Rep. No. 1409, 75th Cong., 1st Sess. 43, 44 (1937).

[16] Hearings before the House Committee on the Judiciary on H.R. 6439, subsequently amended, reintroduced and reported as H.R. 8046, 75th Cong., 1st Sess. 177 (1937) (testimony of then Commissioner Douglas).

misconduct, mismanagement or other irregularities that may have led to the debtor's economic difficulties; and he is to evaluate and report on causes of action in favor of the debtor that may be disclosed by his investigation. He also is to recommend the allowance and disallowance of claims against the debtor (Sections 187; 44 (11 U.S.C. 72)). If it appears that a reorganization might be feasible, he is responsible for preparing a reorganization plan (Section 169). As the House Report pointed out, it is the trustee who "assembles the necessary ingredients" for the plan.[17] And it is on the basis of the trustee's information (see, *e.g.*, Section 169) that "the court and the investors can intelligently decide whether or not proposed plans are fair, equitable, and sound * * *."[18] As the House Report further stated:

> The trustee, as a representative of the court, plays an active role in the formulation and negotiation of plans, and supplies scrutiny and control thereof in the interest of creditors and stockholders. * * * He is made the active head of the reorganization process * * *.[19]

To emphasize that it is the responsibility of the court to pass upon all phases of the reorganization process in no way detracts from the vital role of the trustee. Indeed, it was through him that Congress expected the court to be able properly to perform its functions:

> Only through some such method [as an impartial trustee] can the court be in a position to exercise an informed judgment and to af-

[17] H. Rep. No. 1409, 75th Cong., 1st Sess. 43 (1937).
[18] *Ibid.*
[19] *Id.* at 44.

> ford a critical scrutiny and supervision of the estate at all times. Without its own agent being fully informed and apprised, the court remains too much at the mercy of the competency, vigilance, and integrity (or lack of them) of those who happened to be active in the case. In sum, the independent trustee will put the court in a position to perform its functions adequately in the large, complex cases.[20]

To that end, Section 156 broadly requires that the trustee be "disinterested," *i.e.*, an "impartial" and "independent" "arm of the court."[21]

B. IN ORDER TO INSURE THAT THE TRUSTEE BE DISINTERESTED, HE MUST BE DISABLED FROM BECOMING PRESIDENT OF OR ASSUMING A POSITION OF IMPORTANCE WITH THE REORGANIZED COMPANY

Congress recognized that—

> [I]ncidental to every reorganization * * * are * * * valuable emoluments within reach of those who emerge with control over the new company. *The central problem in reorganiation is to see to it that that power is not exploited by reorganizers but appropriated for the benefit of investors.* * * * So long as [the reorganization] can be governed by the conventions of a few dominant parties, there is great likelihood that that power will not inure to the benefit of the estate. There is greater assurance of it being done if it is placed where it belongs, in the court. It then becomes an asset, so to speak, of the estate. This shift in power, inherent in the device of an independent trustee, is basic and fundamental if the reorganization system is to be reconstituted in the interest of investors.[22] [Emphasis added.]

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[20] *Id.* at 43.

[21] *Id.* at 43, 44, 43.

[22] *Id.* at 44.

Thus, one of the principal reasons for requiring an independent trustee was to prevent control of the reorganization process from being employed by anyone to serve his own ends.

Hence, Section 158 specifically provides that a person "shall not be deemed disinterested" under Section 156 if he comes within three categories of relationships with the debtor,[23] or, more broadly, if "it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor * * * or for any reason an interest materially adverse to the interests of any class of creditors or stockholders." We submit that a trustee who intends or contemplates that he will assume a position of importance—here the presidency—in the reorganized debtor company has "an interest materially adverse to the interests" of, here, the "stockholders" of the debtor within the meaning of that provision.

For example, in evaluating disputed claims and recommending what participation in the reorganized company the plan should give to the various stockholder and creditor interests, a trustee might permit the possibility of employment with the reorganized company to influence him—consciously or unconsciously—to favor those solutions that will best en-

[23] If he (1) is a creditor or stockholder of the debtor, or (2) is, or was an underwriter of any of the debtor's outstanding securities or within five years had been an underwriter of any of the debtor's securities, or (3) is, or was within two years of the filing of the petition, a director, officer or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter. The breadth of Section 156 is not, we note, restricted to the four circumstances covered by Section 158; see 6 Collier, *Bankruptcy* ¶ 7.08, at 1181, n.6 (14th ed. 1965).

hance his prospects with those who are likely to emerge in control of the new company. The plan might be designed to curry favor with those who will obtain control, or to assist in obtaining control for those interests who favor the trustee's continued employment. His interest in insuring his future is therefore materially adverse to the interests of other claimants and stockholders of the debtor. The phrasing of Section 158(4) is designedly broad, and, we submit, that section applies here.

We are aware, of course, that Section 158 speaks to disqualifying characteristics at the time of the trustee's appointment. But if the requirement of Section 156 that the trustee be "disinterested" is to be efficacious, clearly that quality must endure throughout the proceeding and must, at the very least, be assessed with respect to the plan of reorganization.

A further indication of congressional concern that the trustee be truly disinterested is shown by the provision in Section 156 that, in certain circumstances, an "additional trustee" may be appointed. He—in contrast to the independent trustee—may be a director, officer, or employee of the debtor, but his duties are limited to operation of the business and management of the debtor's property (see Sections 156 and 189). He may not, for example, participate in the principal trustee's investigations or in the drafting of a plan of reorganization. Despite the narrow circumscription of his duties, even the additional trustee—apart from the permitted relationship to the debtor—must be disinterested. *In re Ocean City Auto. Bridge Co.*, 184 F. 2d 726 (C.A. 3); cf. *Meredith* v. *Thralls*, 144

F. 2d 473 (C.A. 2), certiorari denied *sub nom. Consolidated Realty Corp.* v. *Meredith*, 323 U.S. 758. Similarly, Section 191 permits the trustee to employ members of the debtor's former management at compensation to be fixed by the court. In explaining that provision, then Commissioner Douglas stated that if members of former management were "to assist in the conduct of the business," they should not "be allowed to act in a fiduciary capacity" if insistent upon "additional opportunities" beyond the "fair salary fixed by the court," such as "insuring their retention by the reorganized company." [24] If former management officials of the debtor hired by the trustee may not be in a position to bargain for their retention by the reorganized company, it would seem to follow *a fortiori* that the independent trustee himself—whose functions Congress considered "difficult to overemphasize" [25] and who Congress thought "should be as free from 'friendliness' to a party as the court itself" [26]—should be so disabled.

In accordance with policy similar to that underlying Sections 156 and 158, Section 221 provides that when the judge confirms a plan of reorganization he shall be satisfied not only that "the plan is fair and equitable," but also that the appointment of the pro-

[24] Hearings before the House Committee on the Judiciary on H.R. 6439, subsequently amended, reintroduced and reported on H.R 8046, 75th Cong., 1st Sess. 174 (1937).

[25] H. Rep. No. 1409, 75th Cong., 1st Sess. 43 (1937).

[26] *Harkin* v. *Brundage*, 276 U.S. 36, 55, quoted approvingly in the legislative history of Chapter X in criticizing friendly trustees under former Section 77B. See S. Rep. No. 1916, 75th Cong., 3d Sess. 21, 27 (1938).

posed directors and officers "is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy." That feature was explained in the hearings leading to the adoption of Chapter X, as follows:

> [I]n passing on the fairness of the plans * * *, the court would have to specifically concern itself with the question of the management of the new company, whether that management was in the interests of the creditors and stockholders, and whether it was in the interest of the public. That concept of the public interest is the introduction of a new element * * *[27]

The appointment of the trustee to a position of importance with the reorganized company raises an unanswerable question whether "the salient facts necessary for a determination of the fairness and equity of a plan of reorganization," which Congress expected the trustee to make "available to the court and the investors as a routine matter,"[28] were properly investigated and disclosed. In our view, considering the evils which led to the reforms of Chapter X, such appointment cannot be deemed, under Section 221, to be "equitable," "compatible with the interests of" (here) the "stockholders," or "consistent with public policy," and a plan contemplating the trustee's employment by the reorganized company is not "fair and equitable."

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[27] Hearing before the House Committee on the Judiciary on H.R. 6439, subsequently amended, reintroduced, and reported as H.R. 8046, 75th Cong. 1st Sess. 182 (1937) (testimony of then Commissioner Douglas).

[28] H. Rep. No. 1409, 75th Cong., 1st Sess. 43 (1937).

Early in the history of Chapter X, this Court held that where an actual conflict of interest exists, compensation for services rendered may be denied a fiduciary, despite the fact that no fraud or unfairness was shown to have resulted from the conflict. *Woods* v. *City Bank Co.*, 312 U.S. 262. The Court reasoned (312 U.S. at 268):

> * * * [T]he incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent.

More recently this Court pointed out that "one who exercises control over a reorganization holds a post which might tempt him to affect or influence corporate policies—even the shaping of the very plan of reorganization—for the benefit of his own security holdings but to the detriment of the Debtor's interests and those of its creditors and other interested groups." *Wolf* v. *Weinstein*, 372 U.S. 663, 642. We submit that that language is as applicable to a fiduciary's future employment as to his present "security holdings." Although the Court in *Wolf* recognized that the remedy was "indeed a severe one," it found it necessary to "order the restitution of all amounts of compensation and reimbursement received by * * *

[the debtor's management] since the start of the reorganization [a period of almost 10 years]"; to do otherwise might "jeopardize the salutary policies of the statute." 372 U.S. at 654.[29]

The court below seemingly indicated that the touchstone of disinterestedness was whether the proponents of a plan "assured" the trustee of future employment with the debtor or merely intended to recommend it to the court and the board of directors (334 F. 2d at 119–120). Such a distinction would be unworkable in practice; it would place a difficult and unnecessary burden on reorganization courts in Chapter X proceedings to insure that the trustee's self-interests have not been preferred to those he is required to serve. Moreover, it would seriously weaken the protections which the requirement of a disinterested trustee was intended to provide for creditors and stockholders, for the possibility of future employment may create just as great a danger of a conflict of interest as its certainty. Sections 156 and 221 must be deemed to cover both situations if the Act is to achieve the salutary purpose that Congress intended it to serve.[30]

[29] We urge the analogy to *Wolf* as illustrative of the necessity for a prophylactic rule despite its severity, not to suggest that it follows from that case or our position here that this trustee necessarily would have to forego compensation for his work as trustee.

[30] The respondent, in his Reply (p. 11) to the Commission's Memorandum in support of the Petition, referred to the fact that in 1958 the Commission sought to have Chapter X amended to prohibit a trustee or his attorney from being employed by the reorganized company for a period of two years after substantial consummation of a plan. No hearings were held on the bill (H.R. 11589, 85th Cong., 2d Sess. (1958))

In sanctioning the confirmation of the plan of reorganization involving the future employment of the trustee, the court below countenanced a substantial erosion of what has been viewed as the critical safeguard for the protection of all public investors in a corporate reorganization proceeding conducted under Chapter X of the Bankruptcy Act—the totally "disinterested" trustee. Unless the trustee is completely disinterested——that is, free from any factor that, consciously or unconsciously, might tend to cause personal considerations to influence him—he is not able adequately to fulfill those substantial responsibilities and serve those functions that Congress intended for him. We urge, therefore, that a Chapter X trustee may not, consistent with his fiduciary role, accept or contemplate employment with the reorganized company. A rule disabling him from doing so would insure his independence and impartiality.

To be sure, in a rare instance such a rule might operate to the detriment of a reorganized company that might not be able to obtain as proved and as experienced an executive official as the trustee. But we believe that the possibility of that happening in an occasional case is far outweighed by the public interest in insuring the trustee's single-minded devotion towards bringing about a fair and equitable reorgani-

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that was introduced for that purpose. There is no basis for the significance respondent has attached to that largely clarifying proposal, see *Wong Yang Sung* v. *McGrath*, 339 U.S. 33, 47–48; *Black* v. *Magnolia Liquor Co.*, 355 U.S. 24, 26–27, particularly since, in any event, "we deal here with remedial legislation whose language should be given hospitable scope" (*Magnolia Liquor Co.*, *supra*, at 27).

zation—an interest which requires the strict rule which we urge.

C. THE FACTS HERE ILLUSTRATE THE NEED FOR THE PROPHYLACTIC RULE SOUGHT

We discuss in greater detail elsewhere facts relating to the plan of reorganization recommended by the trustee and approved by the court. See *supra*, pp. 11–16; *infra*, pp. 36–49; 56–69. Here we sketch only how certain features of the plan seem to have placed the trustee in a position of conflicting interest, thus demonstrating the need for disabling a trustee from contemplating future employment with the reorganized company.

Throughout this proceeding the trustee and persons who were charged with being principally responsible for the debtor's collapse (the holders of the Caplan mortgage), and persons allegedly further responsible for the debtor's financial difficulties (Merrill-Stevens), have contemplated that the trustee would become president of the reorganized company. Under the 1959 plan, to which the Commission and the Stockholders Committee had objected because the trustee had not conducted the investigation contemplated by Section 167 (II 510, I 127), the trustee became the salaried president of the reorganized company (II 517, 525), while the persons he later charged with having "wrecked" the debtor by "gross mismanagement" emerged in control (see *supra*, p. 7). While the district court's order vacating the order confirming this plan recites that "the Trustee's investigation disclosed facts not known to the Trustee or to the Court" (II 619), the fact remains that an earlier recognition of a trustee's duty to investigate under Chapter X might have disclosed those belatedly discov-

ered facts thereby obviating some of the substantial difficulties with which the stockholders are now burdened (see pp. 59–61, *infra*).

When two plans of reorganization were proposed in 1962, the trustee recommended to the court the internal plan—which specifically contemplated that he would become president of the reorganized company [31]—and opposed the alternative cash plan of selling the debtor's assets to third parties. The trustee's recommendation was based upon his view that an "internal" plan of reorganization was "more fair and equitable" than an external sale or cash plan because the external plan "must give the new owners complete or nearly complete ownership of the debtor and eliminate any prospect for the unsecured creditors to obtain any substantial benefit from the future prospects of the business" (II 660–661). The trustee took no affirmative steps to let it be known that he would "receive and welcome" (II 97–98) external proposals. Further, the district court noted in considering the two plans—one of which provided for the trustee's future employment

[31] On May 2, 1962, during the hearings on approval of the plans, there was introduced into the record a proposed five year contract between the proponents of the plan and the trustee, pursuant to which the reorganized company would employ him as president (II 275, 296–298). This contract is specifically referred to in the internal plan of reorganization (II 707). The court of appeals recognized that the contract was "between the major creditors and the trustee" (334 F. 2d at 119).

As noted (p. 6 *supra*), upon confirmation of the 1959 plan, the trustee resigned in order to assume that office and a successor trustee was appointed. The latter was subsequently removed before the order of confirmation had been vacated and the original trustee was reinstated (I 38, 41).

and one of which did not—that the trustee "would be perhaps inclined to lean to his employment" (II 332).

In addition, there were serious objections to claims of two major creditors totalling approximately $2,000,000. The trustee decided not to pursue those objections and instead recommended plans which allowed the claims almost in full; plans under which one of the creditors (Merrill-Stevens) receives about 40 percent of the common stock of the reorganized company—an interest sufficient to wield a commanding vote in selecting the new president.[32] The trustee's action on these compromises (see pp. 12–15, *supra*) was of critical importance, for as we later show (Point II, *infra*), the court had no record before it or basis upon which to evaluate the trustee's judgment.

We do not suggest that the trustee's recommendations were deliberately designed to promote his personal interest. But the requirement in Section 156 that the trustee be "disinterested" is to avoid even the possibility of such conflicts of interest. And as this Court has stated, the evil is not that conflicting "interests are always corrupt but [that] they are always corrupting" (*Mosser* v. *Darrow*, 341 U.S. 267, 271). See also 6 Collier, *Bankruptcy* ¶ 7.08, at 1181 (14th ed. 1965).

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[32] We are advised that, after the present plan was approved and confirmed, the new board of directors, on August 23, 1965, unanimously elected the trustee president of the reorganized company and the board approved a management contract whereby the trustee was employed for a period of five years at an annual salary of $30,000 plus bonuses and common stock as approved by the Board; and that the district court has ratified all actions of the new Board taken at this meeting.

"A trustee," Judge Cardozo said, "is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard * * *." *Meinhard* v. *Salmon*, 249 N.Y. 458, 464. Under Chapter X, adherence to that standard, we urge, can be assured only if the trustee is disabled from assuming the presidency of or any position of importance with the reorganized company.

II. THE LOWER COURTS' APPROVAL OF THE COMPROMISES OF SERIOUSLY DISPUTED SUBSTANTIAL CLAIMS WAS IMPROPER BECAUSE THE RECORD DOES NOT PERMIT AN ADEQUATE EVALUATION OF SUCH CLAIMS OR DISCLOSE THE BASIS FOR THEIR SETTLEMENT

The court of appeals recognized that the confirmed plan provides for "compromises of approximately $2,000,000 in two seriously disputed claims" (364 F. 2d at 941). Under that plan the $330,000 Caplan mortgage claim is "compromised" by paying the holders thereof $280,500 (the actual consideration they paid therefor) over five years[33] and giving them stock for their interest on the claim; and the Merrill-Stevens claim of $1,628,284 is "compromised" by reclassifying the allegedly secured portion thereof (approximately $575,000) as unsecured, and issuing for the entire claim approximately 40 percent of the common stock of the reorganized company (III 250–252, 282). The record contains no evidence, however, upon which the merits of these claims could be evaluated,

[33] The plan subsequently was amended to provide for the payment of $250,000 immediately upon consummation. See *supra*, p. 13, n.11.

or upon which the district court could have made the "informed, independent judgment" (*National Surety Co.* v. *Coriell*, 289 U.S. 426, 436) which is necessary for approval in a Chapter X proceeding of such important determinations.

While compromises are "a normal part of the process of reorganization,"[34] like other aspects of a plan of reorganization they must satisfy the standard of fairness in Sections 174 and 221(2). *Conway* v. *Silesian-American Corp.*, 186 F. 2d 201 (C.A. 2). Reorganizations are thus unlike litigation between individual disputants, where "there is no occasion for a court to pass on the fairness or unfairness of a compromise settlement." *In re Chicago Rapid Transit Co.*, 196 F. 2d 484, 490 (C.A. 7).[35] Although generally the reorganization courts have a broad discretion in approving compromises upon any reasonable basis, appellate courts "have had no hesitancy to reverse or remand for further consideration orders approving compromise where such orders were found to be an abuse of discretion, or based upon insufficient investigation or information, or not in the best interest of the creditors and stockholders. [Citations omitted.]" *Ashbach* v. *Kirtley*, 289 F. 2d 159, 163 (C.A. 8).

In *Ashbach*, the court set aside an order of the district court which had approved, after a hearing at which no testimony had been introduced, a compro-

[34] *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 130.

[35] Cf. Fed. Civ. P. 23(e), providing that class actions may not be dismissed or compromised without the approval of the court. Class actions, like reorganization proceedings, involve the rights of persons who may be represented by others similarly situated.

mise of a judgment obtained by the trustee in a suit for mismanagement against a person who formerly controlled the debtor. It stated (*id.* at 166) "that there were too many questions left unanswered for the court to arrive at [the necessary] 'informed and independent judgment'" (quoting *Coriell, supra*). "With the paucity of information furnished to the court by the trustee and his counsel, we do not see how that judgment could be properly exercised." *Ibid.* Similarly, in *Conway* v. *Silesian-American Corp., supra,* the Court of Appeals for the Second Circuit reversed the lower court's approval of a Chapter X plan of reorganization, consisting in the main of a settlement of conflicting claims by a group of Swiss banks. The court remanded the case for further proceedings, since it was "compelled to find a lack of sufficient proof of the adequacy of the settlement proposed to justify acceptance of the plan as fulfilling the statutory standards [of fair and equitable]." 186 F. 2d at 212. Likewise, in *In re Chicago Rapid Transit Co., supra,* the court of appeals vacated an order approving a "businessman's settlement" of mutual claims between the debtor and a former lessor, because it was approved "* * * solely on the basis of expediency and the desire to forestall further lengthy and expensive litigation, with no attempt at considering the relative merits of the conflicting claims of the parties." 196 F. 2d at 485.

In the present case, as we shall now show, the record similarly contains insufficient evidence upon which the reorganization court could make an "informed, independent judgment" as to whether the

compromise of these two substantial claims was a fair one. Before the district court could render such a judgment, it was required to evaluate the claims and ascertain the basis upon which they were being settled. For only then could it determine whether the amount in which the claims were being allowed was fair to the security holders.

When the district court initially approved the internal plan, it gave the following explanation of its acceptance of the compromises (II 372–373):[36]

> Negotiations by the trustee and the creditors committee resulted in proposed compromises of the Caplan mortgage claim and the Merrill-Stevens claims, which compromises are included in the Internal Plan of Reorganization, initially filed by the creditors committee. It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders Committee is too remote for serious consideration.

[36] The district court added nothing to this explanation when it confirmed the amended plan upon remand following the second appeal, since it erroneously concluded that its approval of the settlement had been already affirmed by the court of appeals (see *supra*, p. 10, n. 10).

> If the unsecured creditors approve the Internal Plan with these compromises, the only class that can object are the stockholders, and the court has found in the Valuation and Insolvency Order that the stockholders have no equity even if these two claims were disallowed in toto. The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act.

This statement falls far short of an adequate basis for approving the compromises. It gives no explanation of how the court evaluated the strengths and weaknesses of the claims, or upon what grounds it concluded that a settlement which allowed the claims in major part was "fair and equitable." The suggestion that, if the creditors approved the plan, there would be no other group that would have an interest in the settlement ignores the fact (1) that if the compromises give the Caplan mortgage holders and Merrill-Stevens an excessive amount (as the record strongly suggests), other creditors, had the facts been fully explained to them, might well have rejected the plan, under which they gave up a substantial portion of their claims;[37] and (2) that the stockholders may have an interest since, as shown be-

[37] The court of appeals thought it "significant" that creditors had not complained of the purported compromises (364 F. 2d at 941). In *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 114, however, this Court held that a plan of reorganization which is unfair to some persons may not be approved by the court even though the vast majority of creditors have approved it.

low (pp. 49–56), the district court's finding of insolvency was invalid because it was based on an erroneous standard of valuation. The other stated ground of approval—that the alternative to settlement was "extensive litigation at heavy expense" and "unnecessary delay in reorganization"—is a valid consideration only when weighed against an informed evaluation by the court of the likelihood of successful prosecution of the claims. For litigation and delay always are the alternative to settlement, and whether that alternative is worth pursuing necessarily depends upon a reasoned judgment as to the probable outcome of litigation.

The need for a fully informed judicial evaluation of the settlement is particularly important in this case in view of the district court's holding that because of the debtor's insolvency the stockholders are not entitled to participate in the reorganized enterprise. The trustee's report of investigation of the Caplan mortgage claims and the Commission's submissions indicate that there is serious basis for believing that those claims and the Merrill-Stevens claims should be disallowed in at least substantial part. If these claims are subject to such serious infirmities—and that can only be finally determined upon the basis of a full record—then any fair settlement thereof necessarily would substantially reduce the creditors' claims allowable against the estate. In view of the district court's use of erroneous valuation standards (see point III, *infra*), this could lead to a finding of solvency, permitting participation in the estate by the stockholders. Moreover, the trustee's espousal of these compromises particularly called for

careful scrutiny because under the plan the holder of the largest of the two claims (Merrill-Stevens) acquires 40 percent of the stock of the reorganized company, and thus obtains a major voice in selecting the president of the company—an office to which, as the plan contemplated, the trustee has now succeeded (see *supra*, p. 35, n. 32).

In the light of these considerations, we examine the bases upon which the trustee settled these claims and the district court approved the settlement.

A. THE CAPLAN MORTGAGE CLAIM

The trustee's report of investigation showed that Abrams, Shaffer and Erdman, who were the principal holders of the Caplan mortgage claim,[38] had a dominant influence on the financial affairs of the company, which, according to the report, had been "wrecked by gross mismanagement * * *" (II 584). The trustee stated that "[a]ll the participants in the Caplan Mortgage were privy and acted with the wrongdoers * * *" (II 1096) in exercising a high degree of control over the debtor to take advantage of their inside position in obtaining large amounts of stock at prices below the market (II 611–612). The trustee's report also details how more than 1,800,000 shares of the debtor's stock reached the public through Abrams and Shaffer without registration under the Securities Act of 1933 (II 609–612), and shows that within a year and a half immediately preceding the institution of the reorganization proceeding, purchases and sales of the debtor's

[38] They held of record or through nominees more than two-thirds of the principal amount (II 598–599).

stock by Shaffer and his wife alone resulted in a net profit to the Shaffers of $244,000 (II 605).

The trustee urged that "persons such as Abrams, Shaffer and Erdman * * * should be barred in this equity proceeding from profiting at TMT's expense. Their claims should be reduced by the profits they have made on sales of TMT stock * * *" (II 612). Furthermore, the trustee contended that they "should be required to account for profits made through diversion of corporate opportunities" (II 609). As a minimum, he urged, their claim should be "disallowed in toto or be subordinated to the claims of general creditors, including stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 * * *" (II 1096).

In 1961, following the filing of the trustee's report, objections to the Caplan mortgage claim were filed by both the trustee (II 1091, 1096) and the Commission (II 1093). No hearings were ever held on the objections. Instead, the claims were compromised for more than four fifths of their principal amount (see *supra*, pp. 13, 36). The only explanation in the record of the basis of this compromise is the following statement by the trustee:

> The compromise of the Caplan claim was worked out between the attorney for that group, my attorney and myself. It was done in a conference the three of us had with the Court. It was completed after considerable deliberations and negotiations. It was submitted to the Court and approved by the Court and that is the way

we came about to reach that conclusion [II 284].[39]

This four-sentence explanation by the trustee of why he virtually abandoned his previous objections to these claims—objections which rested upon a substantial factual basis[40]—casts no light upon the fairness of the compromise. It says only that the trustee, his attorney and the attorney for the claimants "worked out" a mutually satisfactory agreement. It is impossible to tell on this record whether the settlement was a fair one, since there is no basis for evaluating either the merits of the claims or the theory upon which the settlement rested. The district court could not possibly have made an informed judgment upon the issue, yet the making of such judgment was its clear duty before approving, as fair and equitable, a plan embodying that settlement. See *supra*, pp. 36–38. Moreover, in such circumstances the court of appeals could not validly have treated the district court's approval of the settlement as a proper exercise of the latter's discretion, since there was no ascertainable basis upon which the district court exercised any discretion.

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[39] Presumably the trustee's reference to court approval is to whatever informal approval may have been given by the court in the conference alluded to, since, as noted, there has been no hearing on the claims or the objections and no separate order entered approving the compromise prior to confirmation of the plan (*supra*, p. 43).

[40] The investigation underlying the trustee's report covered 14 days of hearings, at which there was taken testimony of 33 persons including all but one member of the Caplan mortgage group. The record of such investigation consists of 2200 pages of testimony and more than 60 exhibits (II 582–583).

B. THE MERRILL-STEVENS CLAIMS

As noted (*supra*, pp. 14–15), under the plan the allegedly secured portion of Merrill-Stevens' claims, $574,580, or about 1/3 of its total claims of $1,628,284, was reclassified as unsecured and the entire claim was allowed (III 251). There was no hearing on the serious and substantial objections made by the Commission and by the Committee to the bulk of these claims (III 405, II 1042). They urged, in substantial detail, that the debtor had meritorious defenses and off-sets or counterclaims to these claims. With respect to the claim of more than $1,000,000 for work done on the Carib Queen, the vessel whose boilers failed on its maiden voyage, they alleged that Merrill-Stevens (a) did not properly adapt the vessel, (b) did not comply with the terms of the contract to do so, and (c) did not properly repair the vessel after its ill-fated maiden voyage (III 406–407, II 1045–1068). The Commission and the Committee also contended that Merrill-Stevens performed work not covered by the original construction agreement, that no agreement had been reached as to the amount the debtor owed for such work and that Merrill-Stevens was required to establish the value of such work before the debtor was liable therefor (III 406, II 1045–1065). Merrill-Stevens filed an answer to the Commission's objections in which it essentially admitted the existence of certain construction deficiencies in the Carib Queen and the failure of the boilers, but disputed that it was responsible therefor (II 1098); it never replied to the Stockholders Committee's objections.

The trustee filed a motion in December 1961 to have the Merrill-Stevens claims allowed summarily without a hearing. The motion stated that two attorneys in the office of the trustee's counsel had examined "the factual data gathered in the trustee's investigation [41] of the objections to the Merrill-Stevens claim, and it is the considered opinion of both attorneys that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it" (II 22, 26). Objections to the trustee's motion were made by the Commission (II 1073), the Stockholders Committee (II 37), the Department of Justice (II 647) and the Caplan mortgage group (II 636). At the hearing on the trustee's motion, the district judge stated:

> I am concerned myself. I do know that whoever turned that vessel loose with the boilers in it, somebody made a bad mistake. I don't know who it was. [II 36.]

The district court never ruled on the motion, nor has there ever been a hearing with respect to these claims and objections to them.

When the trustee was asked at a hearing in 1962 to give the basis for his compromise of the Merrill-Stevens claims, he read from a letter sent to him by counsel for the Commission which suggested that, be-

[41] The trustee's motion states: "This investigation consisted of an examination of numerous documents assembled by the SEC during its investigation, together with copies of statements made by individuals which had been obtained during the investigation. Also examined were numerous documents and statements furnished by Merrill-Stevens in support of its answer to specification of objections by the SEC" (II 25).

cause of the necessity for proof by testimony of experts and witnesses to events which occurred in 1956 and 1957, it would be helpful if possible to reach an agreement with Merrill-Stevens, and stated: "And that is what I did. I reached an agreement with Merrill-Stevens" (II 284).

Since the alleged compromise does not reduce the amount of the claims allowed, the only thing that Merrill-Stevens is giving up is an allegedly secured position on about one-third of its total claim. But the Department of Justice contended that under maritime law these claims were not secured (II 648), and their status has not been determined. Nor has there been a determination of the value of the vessels that are the alleged security for the claims, or whether the Caplan mortgage represented a prior claim on these same vessels, as the Caplan group contended. All of these determinations were required by Section 197 of Chapter X before the claims could be allowed as secured.

Here, as in the case of the Caplan group claims, the only explanation in the record of the basis for the settlement is that it reflected an "agreement" the trustee had reached with the claimants—an agreement that presumably reflected the "considered opinion" of two lawyers in his counsel's office who, based on their examination of the factual data obtained in the trustee's investigation of the claims, concluded that the possibility of materially reducing the claims was "remote." Moreover, Merrill-Stevens may not be giving up anything by accepting the reclassification of one-third of its claims from secured to unsecured. Once again, it is impossible to determine whether the

settlement is a fair one—whether it reasonably reflects the strengths and weaknesses of the claims, and for what reasons the trustee concluded that, despite the serious questions that the Commission and the Stockholders Committee had raised about these claims, it was not worth contesting them. A more careful analysis by the district court based upon a more detailed record was necessary before such a settlement could be approved. Cf. *Upson* v. *Otis*, 155 F. 2d 606, 614 (C.A. 2) where, in holding that the district court had abused its discretion in approving the settlement of a stockholders' derivative suit, the court of appeals pointed out: "A record consisting in considerable part of colloquies between counsel and the judge is never satisfactory * * *."

In its Protective Committee Report that led to the adoption of Chapter X, the Commission pointed out that unless settlements were "made in light of all of the facts after thorough investigation and publicity" and "negotiated by truly independent committees who are able to deal at arms' length," they raise "grave problems." It noted that security holders in appraising "all of the facts would have no intelligent basis for deciding whether that part of the plan was fair or unfair," and that "[w]ithout such safeguards, plans of reorganization may throttle and suppress just causes of action and deprive security holders of valuable assets."[42] In this case the "compromises" involved an

[42] Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees*, Part I, p. 312 (1937).

abandonment not only of causes of action that might have brought valuable assets into the estate (III 192–193), but of possible offsets to claims against the estate. Although the compromises may have constituted a fair settlement of the competing liens of Merrill-Stevens and the Caplan groups (the factor which apparently primarily induced the district court to approve them, II 370–373), the fairness of such compromises vis-a-vis the public stockholders could not be determined on this record, and the district court therefore erred in confirming the amended plan which embodied them.

III. THE DISTRICT COURT USED AN IMPROPER BASIS FOR VALUING THE DEBTOR, AND ITS FINDING THAT THE AMENDED PLAN IS FAIR AND EQUITABLE CANNOT STAND

1. Chapter X requires that for the district judge to approve and confirm a plan of reorganization he must find, among other things, that the plan is "fair and equitable."[43] This standard incorporates the absolute priority doctrine under which creditors and stockholders may participate under a plan only in accordance with their respective priorities.[44] While this doctrine requires that senior classes must receive full compensation for their claims before junior interests may participate,[45] it also means that creditors are not to receive greater compensation at the expense of stockholders.[46] Since participation by junior interests

[43] Sections 174 and 221(2) of Chapter X.

[44] *Securities and Exchange Commission* v. *United States Realty & Improvement Corp.*, 310 U.S. 434, 452.

[45] *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106; *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510.

[46] Cf. *Knight* v. *Wertheim & Co.*, 158 F. 2d 838 (C.A. 2).

depends upon whether the claims of senior interests have been fully satisfied, whether a plan of reorganization excluding junior interests is fair and equitable depends upon the value of the reorganized company.

In the present case the district court excluded the stockholders from participation because of its finding that the debtor was insolvent. That finding, therefore, was critical to the court's determination that the amended plan is fair and equitable, and if that determination was not made in accordance with the proper standards of valuation, neither the approval nor confirmation of the plan can stand.

This Court has declared that in a Chapter X reorganization proceeding the estimated future earnings of the debtor are the primary basis for valuing it. *Consolidated Rock Products Co.* v. *DuBois, supra,* 312 U.S. at 526 [citations omitted, emphasis added]:

> As Mr. Justice Holmes said in *Galveston, H. & S. A. Ry. Co.* v. *Texas,* 210 U.S. 217, 226 "the commercial value of property consists in the expectation of income from it." Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity. The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be

> fair and equitable. Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. *But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and conditions of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance.* * * *

This Court also stated (pp. 525–526), that "[u]nless meticulous regard for earning capacity be had, indefensible participation [or, as in the present case, exclusion] of junior securities in plans of reorganization may result."

In valuing the debtor in the present case, the district court relied upon its past earnings record and failed to consider "all facts relevant to future earning capacity * * * including * * * all circumstances which indicate whether or not * * * [the past earnings] record is a reliable criterion of future performance" (*Consolidated Rock Products, supra*). Thus the court indicated that the debtor should be valued "as it now exists" rather than "when reorganized,"[47] and that there were "no possible future prospects other than what is going on" (III 55–56).

The court's failure to use the proper standard of valuation is particularly demonstrated in the follow-

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[47] During the 1962 hearings, the following colloquy occurred between the court and Mr. Mason, former Committee Counsel (II 170):

ing statement it made in 1965 when it declined to change its original determination that the debtor was insolvent (III 211–212):

> The SEC and the Stockholders Committee insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee nor the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable (III 267).

2. In July 1962 the court determined that the debtor's going-concern value was $2,780,000 by projecting the then current earnings of the debtor (for the first five months of 1962) at the same level for the balance of the year and arriving at estimated earnings before taxes for 1962. The resulting amount, $568,000, was reduced by estimated income taxes to

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Q. But if this enterprise were out from under the proceedings, would it?

The COURT. Well, we are dealing with an organization that is in. Let's assume that it will stay right there and try to get the value. It is not going to get out until it is reorganized.

Mr. MASON. We are trying to get the value when reorganized.

The COURT. That is of no importance to me. Let's value it as it now exists to determine what should be done in these proceedings.

$278,000 and capitalized at 10 percent (II 387.5). Comparing the going-concern value of $2,780,000 with the total claims of approximately $5,400,000 that would be allowed against the debtor, the court found the debtor insolvent (II 387.5–387.6). During hearings held on valuation in November 1964 and January 1965, the trustee declined to make any estimate of future earnings or to place in the record the detailed information necessary for making such estimates (III 141–143, 148–150, 294). The court, without estimating future earnings at all, found that the debtor was "more insolvent" than in 1962 (III 266).

The 1962 determination of valuation recites that the "only reliable factors are what the debtor is doing now" (II 387.7), and the court expressly refused to consider the future growth of the debtor's business, which the record then indicated was likely.[48] While the district court said at that time that the effect of increasing the fleet of vessels and truck trailers was "too speculative and uncertain to warrant consideration" (II 387.4), only three weeks earlier, on June 19, 1962, it had approved the purchase by the trustee of an additional freight-carrying vessel (II 357). As a result of the debtor's continued growth the court authorized the purchase of further revenue producing equipment, and from the time of the valuation hear-

[48] About a month before the court entered its July 1962 order valuing the debtor and finding it insolvent, the trustee petitioned for authority to purchase a fourth vessel (II 310.1), stating: "The trustee has been offered * * * more traffic * * * than the existing three vessels can handle * * * and there is a backlog of merchandise * * * for movement to Puerto Rico" (II 310.1).

ings in 1962 to the hearings following the remand in 1965 its vessels increased from three to five (II 310.1, III 78) and its truck trailers from 331 to 670 (II 222, III 137).[49]

To value a debtor "as it now exists" rather than "when reorganized," may improperly reduce the valuation because of the inherent limitations of a business operated under court trusteeship. Moreover, the current earnings in this case reflected a deduction of reorganization expense which, of course, is not an ordinary business expense (II 267). A proper valuation of a debtor, as reorganized, requires recognition of contemplated changes in operations and acquisitions, and the effect thereof on future revenues and earnings. The lack of any estimate of future earnings at all precludes the court from properly determining the debtor's valuation and the fairness of the plan or reorganization.

3. In approving the order confirming the amended plan, the court of appeals stated that it was not "called on to decide whether the district court has accurately computed the going concern value of the debtor * * * but only whether its decision that the debtor is insolvent is clearly erroneous. * * * The finding of insolvency cannot be held clearly erroneous" (364 F. 2d at 941). But a finding that rests

[49] Assets, and the excess of assets over liabilities, have each increased by over $1,250,000 in the approximately three year period, and the net book value of the estate has thus increased over 65 percent, principally through the investment of earnings in the purchase of new vessels and truck trailers (II 387.2, III 75).

upon the application of an erroneous legal standard is by definition "clearly erroneous," and, as we have shown, the district court's finding of insolvency is here subject to that infirmity.

This Court recognized in *Consolidated Rock Products* that, to a degree, all going-concern enterprise valuations are uncertain and mathematical precision in assuring that no creditor participates beyond his claim is impossible. That consideration, however, makes it all the more important that before a court should conclude that 7,000 stockholders have no further interest in the debtor, it should make "an informed judgment which embraces all facts relevant to future earning capacity * * *" (*Consolidated Rock Products, supra*). The district court having failed to do so, the order of confirmation here should be reversed, as was the order confirming the reorganization plan in the *Consolidated Rock Products* case, since, as in that case,

> * * * On this record no determination of the fairness of any plan of reorganization could be made. Absent the requisite valuation data, the court was in no position to exercise the "informed, independent judgment" [citation omitted] which appraisal of the fairness of a plan of reorganization entails. [312 U.S. at 520.]

On the basis of a properly developed record, it may turn out that the debtor's going-concern value is sufficient to provide an equity for stockholders after the

satisfaction of the claims of creditors with interest—particularly if it should appear that large claims against the debtor have been unfairly compromised in favor of the claimants (see point II, *supra*).

IV. THE COURTS BELOW ERRED IN REFUSING TO CONSIDER THE MERITS OF THE STOCKHOLDERS' CLAIMS BASED ON ASSERTED VIOLATIONS OF THE FEDERAL SECURITIES LAWS

It was repeatedly contended in the district court on behalf of the non-management stockholders of the debtor that many of them had claims against the debtor arising out of the sale of the debtor's stock to them in violation of the federal securities laws, and that these claims entitled them to participate under any plan of reorganization as general creditors.

The Stockholders Committee's contentions were set forth in various documents filed in 1961 and 1962 (see pp. 59–60, *infra*). The Committee stated in a proof of claim filed in June 1962 (II 364–365):

> 1. With the exception of a very minor amount that appears to have been validly issued, the shares purchased by non-management stockholders were issued by the debtor without registration in violation of the Securities Act of 1933 and the Rules and Regulations issued thereunder * * *.
>
> 2. The shares so issued were issued by the debtor in the course of and in pursuance of a conspiracy with its financial advisors, Joseph Abrams and Arthur H. Shaffer, with Dr. Robert Erdman and certain other persons, and were sold in the public market by certain of the conspirators in violation of the Securities Act of

1933 and the Rules and Regulations issued thereunder * * *.

3. Members of the investing public were induced to purchase such shares and to pay high prices for them by false and fraudulent representations made by the debtor and by other members of the conspiracy in violation of law and by manipulative and deceptive devices and contrivances used and employed by the debtor and other members of the conspiracy in violation of the Securities and [sic] Exchange Act of 1934 and the Rules and Regulations issued thereunder.

It was charged, in further detail, that the 1955 and 1956 financial statements issued by the debtor contained an overstatement of assets resulting from improper transactions; that no disclosure was made as to the lack of independence of an accountant who certified the debtor's financial statements; that no disclosure was made of substantial amounts of the debtor's stock issued to other members of the conspiracy for inadequate consideration; that the debtor's stock was exchanged for valueless or substantially valueless services and property, with a substantial block of stock having been issued on the basis of a false and fraudulent appraisal of certain property; that many untrue statements concerning future prospects for the debtor were published as part of a publicity campaign intended to manipulate the market for the debtor's stock; that the debtor issued to one of the conspirators, Joseph Abrams, stock of the debtor in exchange for unregistered securities of another corporation and that later the debtor sold those unregistered

securities to other members of the conspiracy at discount prices (II 365–367).[50]

The court of appeals agreed with the conclusion of the district court that these formal proofs of claim, filed in June 1962, should have been filed prior to the April 14, 1958, bar date for filing proofs of claims and that, even if "the bar date should not apply because many of the details which provide the bases for these claims were unknown until the report of the Trustees' [sic] investigation filed July 1, 1960 * * * [n]o valid reason or excuse is given for the delay * * * until June 1962" (364 F.2d at 939–940). The court of appeals noted that the district court had alternatively held, without a hearing, that these claims were without merit on their face (*id.* at 939); it did not, however, reach that issue.

We shall show that the question of timeliness here does not turn on the filing of formal proofs of claims and that there was no delay in asserting the claims and that, in any event, the district court failed to meet its independent responsibility—apart from any possible equitable bar to the claims—to insure that the plan was fair and equitable to these stockholders on this issue. Since the claims were not considered on the merits by the court below, we shall discuss them only to show sufficiently that they had

[50] The trustee's report of investigation gave substantial support to the fact that these activities were all involved in connection with the investment by members of the public of many millions of dollars (see pp. 42–43, *supra*). As therein stated: "The rise and fall of TMT can be told in the light of circumstances and persons involved in its stock transactions" (II 585).

substantial legal foundation, requiring their full consideration by the district court.

A. IT WAS ERROR TO REFUSE TO CONSIDER THE CLAIMS ON THE GROUND OF UNTIMELINESS

1. The claims were timely asserted. Unlike ordinary creditors who, at the outset of a Chapter X proceeding, are fully aware of their claims against the debtor, the approximately 7,000 stockholders could not know the details upon which violations of the securities laws could be alleged until the trustee's report was filed in 1960, two years after the 1958 bar date. Indeed, as we have noted, the district court's order vacating the order confirming the earlier plan specifically states that "the Trustee's investigation disclosed facts not known to the Trustee or to the Court" (II 619). In these circumstances, the claims cannot be viewed as having arisen before 1960. Cf. *Holmberg* v. *Armbrecht,* 327 U.S. 392. Nevertheless, the court of appeals affirmed the district court's refusal to permit filing after that date, or to set a new date for filing.

The trustee's report was filed on July 1, 1960. Eight months later, in February 1961, the trustee himself stated: "The [Caplan] Claim should be disallowed in toto or be subordinated to the claims of general creditors, including stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 * * *" (II 1096). The next month, March 1961, the Committee filed a petition for leave to file a Statement of Position (II 962), to which was annexed a proposed statement (II 1037) articulating the right of non-management stock-

holders "to rank in any reorganization as general creditors" (II 1039). The court denied the petition without prejudice to the right of the Committee "to present its views at the proper time in the course of these proceedings" (II 861).

When, in March 1962, the trustee announced that a new plan was being drafted (II 40), the Committee submitted suggestions for the formulation of a plan of reorganization, again asserting the stockholders' claims (II 1074, 1083). When the proposed plans were circulated, the Committee filed proposed amendments, still again urging recognition of the stockholders' claims (II 1086). Thereafter the trustee discussed and rejected these contentions in a report filed with the court and distributed to the parties prior to the 1962 hearings on the plans (II 660, 663). Before the approval of the plan, a formal proof of claim was filed by the Committee (II 363). And a proof of claim was also filed by an individual stockholder on behalf of herself and all others similarly situated (II 358).

No lack of diligence on the part of the stockholders sufficient to call into play the equitable defense of laches has been shown, nor has there been demonstrated reliance by, or prejudice to, any party that may have resulted from the alleged delay in assertion of these claims. On the contrary, as shown above, the Stockholders Committee repeatedly made known its contentions in this regard during formulation of the plans and thus no one could have been prejudiced.

With respect to laches, this Court has held: "Where there has been no inexcusable delay in seeking a remedy and where no prejudice to the defendant has en-

sued from the mere passage of time, there should be no bar to relief." *Gardner* v. *Panama R. Co.*, 342 U.S. 29, 31. Moreover, in *Czaplicki* v. *The Hoegh Silvercloud*, 351 U.S. 525, it was held that an action could not be barred by laches unless the party against whom the defense was asserted had been given an opportunity to introduce evidence "to prove the facts which would negative laches." *Id.* at 534, n. 15.[51] Here, since the stockholders had no hearing, there was no opportunity for them to show their due diligence and timeliness.

The affirmance by the court below of the dismissal of the claims without hearing on the ground that "* * * no valid excuse or reason was given for the delay * * *" of almost two years in filing the formal proofs of claim in June 1962, suggests that the court valued form over substance. As shown, the Committee repeatedly made known to the trustee and to the court its assertions prior to the filing of formal claims, and the trustee discussed these contentions in a report he filed and circulated before the hearings on the 1962 plan. In these circumstances, the absence of a technical "proof of claim," which prejudiced no one, did not justify the district court's refusal to examine the merits of the claims.

2. In any event, we submit it was error not to consider the claims even if the stockholders had not been diligent in pursuing them. The district judge is expressly charged with the independent responsibility of insuring that only fair and equitable plans of reor-

[51] See also, *Baker* v. *Nason*, 236 F. 2d 483, 493 (C.A. 5) (the defenses of laches and estoppel "are affirmative defenses and call for a full hearing of the testimony of both sides").

ganization are approved and confirmed (Sections 174 and 221(2) of Chapter X). Thus, the district court had an independent duty to consider the claims, once they were brought to its attention, in order to make a proper determination of the fairness of the plan in view of the many stockholders and the potential aggregate size of their claims.

In *Comstock* v. *Group of Institutional Investors*, 335 U.S. 211, 227, this Court approved a district court's reconsideration of a substantial claim that had previously gone unchallenged on the basis of "the broad responsibility laid upon the court for the equity and fairness of the plan as a whole."[52] That case involved a railroad reorganization under Section 77 of the Bankruptcy Act (11 U.S.C. 205). While a plan of reorganization that had been approved by the Interstate Commerce Commission was before a federal district court for approval, an objection was raised to the allowance of a large claim of the parent railroad against a subsidiary in reorganization, a claim that had previously been unchallenged. The objection was made for the first time three years after the objector had purchased his claim at about ten cents on the dollar and ten years after the proceeding had begun. This Court held that, even if the claim had not been presented to the Interstate Commerce Commission, the district court properly considerd it "[i]n view of the functions cast upon the court in such

[52] The dissenting opinion agreed on this point, stating, "Only by examining the matter now could the court be certain whether the treatment accorded the debt by the reorganization plan was fair and equitable." 335 U.S. at 235.

cases * * *." *Id.* at 227. The Court stated (*id.* at 226–228):

> We think that, in the reorganization proceeding, the courts may entertain on their merits objections to a plan even if made by one who might be barred from asserting a cause of action in his own behalf, if the subject-matter of the objections is such that it goes beyond the objector's individual interests and affects the fairness and equity of the plan * * *.
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> * * * * *
>
> * * * The court will be diligent to protect itself and the public from approval of unfair plans, even by default, and may take for its own use evidence no party would have a right to force upon it. * * *

Of course, in *Comstock* the question was whether the lower courts properly had entertained and accepted untimely objections to claims—and this Court held that they had—whereas here the question is whether they erred in refusing to consider the claims. But this distinction is immaterial. For *Comstock* makes clear that the equitable doctrine of laches should not be applied to consideration of claims of such magnitude as to affect the very fairness and equity of the reorganization plan. Surely, if an unfair plan results from failure to consider claims, there can be little room for discretion in a district court to determine whether or not to invoke the doctrine of laches. Cf. *Young* v. *Higbee Company,* 324 U.S. 204, 214, where, in overturning the decisions of the two lower courts, this Court held that an equitable defense asserted against the person making a contention on behalf of a class in a reorganization should not pre-

clude the granting of relief to the class. We think Chapter X requires that the stockholders be given a hearing on their claims.[53]

B. THE STOCKHOLDERS' CLAIMS HAVE A SUBSTANTIAL LEGAL FOUNDATION

1. The district court's dismissal of the stockholders' claims was based, in addition to the asserted lack of timeliness, on the conclusion that the theory of recovery was "intended to cover stockholders *who acquired their stock on the open market* and not from the debtor"; and that the claims were "vague and indefinite as to who the claimants are and the extent and amount of their claims" (II 379–380; emphasis in original).

The stockholders' claims are premised, *inter alia*, on violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and Rule 10b–5 of the Rules and Regulations of the Securities and Exchange Commission promulgated thereunder (17 C.F.R. 240. 10b–5).[54] While neither Section 10(b) nor

[53] Section 196 of Chapter X provides for a hearing where, as here, objections to claims are made by any party in interest. Section 107 requires a hearing in the event of a controversy as to whether "any creditor or stockholder or class" is affected by a plan of reorganization. In addition, Section 206 states that "any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter," and Section 209 permits "[a]ny creditor or stockholder * * * [to] act in person, by an attorney at law, or by a duly authorized agent or committee."

[54] Our discussion of the liability of the debtor under these provisions should not be construed as an unfavorable reflection upon the possible use of other provisions of the federal securi-

Rule 10b–5 expressly provides for private civil remedies, nevertheless federal courts have permitted private rights of action to those persons injured as a result of violations of these provisions.[55] The district court's holding that the debtor could not be liable to the stockholders because the latter purchased their shares on the open market, rather than directly from the debtor (II 379), ignores decisions holding that under that Section and Rule a lack of contractual privity does not preclude a defrauded buyer or seller of securities from recovering against those who perpetrated the fraud. For example, in *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2), it was held that an action under Rule 10b–5 could be maintained by persons who had purchased common stock of the defendant company on the open market in reliance on a false registration statement that related solely to the defendant issuer's preferred stock.[56] Thus, the stockholders had a substantial claim.

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ties law asserted by stockholders. Section 10(b) and Rule 10b–5, and the cases thereunder, have been selected to illustrate that the stockholders have a valid cause of action.

[55] *E.g.*, *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195, 201 (C.A. 5); cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 430–431.

[56] Similarly, in *Miller* v. *Bargain City, U.S.A.*, 229 F. Supp. 33 (E.D. Pa.), where plaintiff, who purchased stock of the defendant company over-the-counter, had relied upon reports and statements issued by the debtor which were allegedly false and misleading, the court denied a motion to dismiss the complaint for violations of Section 10(b) and Rule 10b–5, holding that privity was not a prerequisite to the right of action. For decisions of other courts which have held or stated that a claimant seeking relief under Section 10(b) and Rule 10b–5 is not lim-

2. The respondent trustee suggests in his Reply to our Memorandum in support of the petition (pp. 15–22) that, even if the stockholders' claims were valid, they would necessarily be subordinated to the claims of other creditors. While, like the question of the validity of the stockholders' claims, it is not necessary to resolve that issue here, we point out that there is substantial authority for the defrauded stockholders' participating in the reorganization on an equal footing with general creditors.

The respondent trustee's argument that the stockholders claims, if allowed, should be subordinated is, in our view, an attempt to reverse the determination of parity status of stockholders rescission claims in insolvency proceedings made by this Court in *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206. In that case, a defrauded stockholder brought suit against a bank, which had ceased operations, "to recover damages upon an executed

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ited to an action against the other party or parties to the purchase or sale but may proceed against a third party who has committed fraud in connection with the transaction, privity of contract being unnecessary, see, *e.g.*, *Hooper* v. *Mountain States Securities Corp.*, *supra*; *Texas Continental Life Insurance Co.* v. *Bakers Bond Co.*, 187 F. Supp. 14 (W.D. Ky.), reversed on other grounds, 307 F. 2d 242 (C.A. 6); *Errion* v. *Connell*, 236 F. 2d 447 (C.A. 9); *Cooper* v. *North Jersey Trust Company*, 226 F. Supp. 972 (S.D. N.Y.); *Freed* v. *Szabo Food Service, Inc.*, CCH Fed. Sec. L. Rep. ¶ 91,317 (N.D. Ill.); *New Park Mining Co.* v. *Cranmer*, 225 F. Supp. 261 (S.D. N.Y.); *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21 (S.D. N.Y.); *Cochran* v. *Channing Corporation*, 211 F. Supp. 239 (S.D. N.Y.); and *H. L. Green Co.* v. *Childree*, 185 F. Supp. 95 (S.D. N.Y.). But cf. *Joseph* v. *Farnsworth Radio & Television Corp.*, 99 F. Supp. 701 (S.D. N.Y.), affirmed *per curiam*, 198 F. 2d 883 (C.A. 2).

rescission of a sale to him of stock of the bank by means of fraudulent representations made by its president and vice president." *Id.* at 208. This Court, in considering "whether plaintiff's judgment is entitled to share equally in the receivership estate with other unsecured creditors' claims" (at 213), declared "that plaintiff's judgment is entitled to rank on a parity with other unsecured creditors' claims." *Id.* at 215.

Respondent seeks to distinguish *Oppenheimer* on the ground that it arose from a national bank liquidation under the National Bank Act, under which distribution was made not by a court of equity, but rather by an administrative official (the Comptroller of the Currency) who was bound by a statute directing "ratable" distribution on all claims. 12 U.S.C. 194. However, there is nothing in the National Bank Act, the federal securities laws, or the Bankruptcy Act which would suggest that the rule of *Oppenheimer* is inapposite here. Indeed, a comparison of the National Bank Act with Chapter X reenforces the conclusion that the defrauded stockholders in the instant case deserve similar equality of treatment under Chapter X.

While the National Bank Act provides for a "ratable" distribution of assets and Chapter X of the Bankruptcy Act provides for a distribution which is "fair and equitable" (Section 174 and 221(2)), equitable considerations govern both statutes. This Court has stated:

> The National Bank Act provides for the "ratable" distribution of assets of insolvent national

> banks. R.S. § 5236; 12 U.S.C. § 194. * * * Congress has seen fit not to anticipate by specific rules solution of problems that inevitably arise in national bank liquidations. Instead, it chose achievement of a "just and equal distribution" of an insolvent bank's assets through the operation of *familiar equitable doctrines* evolved by the courts. * * *[57]

Similar considerations govern the administration of proceedings under the Bankruptcy Act. See, *e.g.*, *Pepper* v. *Litton*, 308 U.S. 295. Thus, under both statutes, the ultimate standard is one of an equitable distribution of assets.

Moreover, even if the claims of defrauded stockholders would be subordinated to those of certain general creditors, the claims might nevertheless be superior to those of other creditors: those who participated in the fraud or were responsible for the debtor's economic collapse.[58] Until a properly developed record has been made, however, there could be no determination of these matters.

3. A final reason given by the district court for denying on their face the claims based on asserted securities laws violations is that the claims were "vague and indefinite as to who the claimants are and

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[57] *American Surety Co.* v. *Bethlehem Bank*, 314 U.S. 314, 316 (emphasis added).

[58] Cf. *Pepper* v. *Litton*, *supra*, and *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307. As we have noted (*supra*, pp. 43, 58, n. 50) the trustee, in his report of investigation, urged that the Caplan mortgage be "disallowed in toto or be subordinated to the claims of general creditors, including stockholders who were sold TMT stock in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 * * *" (II 1096).

the extent and amount of their claims" (II 379–380). But since there are legal issues common to all or to many of these claims—issues which were not resolved by the district court—it would have been wasteful to require each of as many as 7,000 scattered stockholders to prove his claim before those issues had been decided. As indicated above, the claims may be of such magnitude that the failure of the court to deal with them on the merits undermines the basic fairness of the plan and, hence, it is logical and proper that the Stockholders Committee, as a representative of stockholders, be accorded a hearing on the legal issues involved. Should it then be determined that these asserted claims are valid, the court, in accordance with the provisions of Section 196 of Chapter X, could specify a period of time for and the manner in which the individual claims are to be filed or proved.[59]

We submit that in the instant case the repeated contentions of the stockholders spell out a substantial claim for relief under the federal securities laws which might entitle them to participate as creditors under any plan of reorganization, irrespective of the solvency or insolvency of the debtor. The summary rejection of these contentions precludes a finding that the amended plan is fair and equitable and requires a reversal of the order of confirmation and a remand for an appropriate hearing in the district court.

[59] Other courts have not found it difficult to establish procedures to identify numerous interested persons and process their claims. See, *e.g.*, *Derdiarian* v. *Futterman Corp.*, CCH Fed. Sec. L. Rep. ¶ 91,575 (S.D. N.Y.).

V. THE STOCKHOLDERS COMMITTEE WAS ERRONEOUSLY DISCHARGED

Except for an individual stockholder, the Committee is the only representative of stockholder interests in the proceeding, and it has vigorously represented these interests since September 1957, shortly after the proceeding began. The district court, on the basis of its finding that the debtor was insolvent in 1965, discharged the Committee about a month after it had confirmed the amended plan.[60] That action was erroneous.

Section 206 of Chapter X specifies that "any * * * stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter," and Section 209 provides that a stockholder may act "by a duly authorized * * * committee." The statute makes no provision, however, for the discharge of a stockholders committee upon a finding of insolvency, and there are sound reasons why it does not. Substantial increases in the value of a debtor are not uncommon during the course of a reorganization,[61] and such change may require reversal of an earlier finding of insolvency, leading to participation by stockholders. Furthermore, where, as

[60] To the extent the district judge relied on the fact that the Committee sought to litigate issues that had previously been determined, the court erroneously assumed that its determinations had been affirmed in the previous appeal (see p. 10 n. 10 and p. 16, *supra*).

[61] See, *e.g.*, *Chase* v. *Austrian*, 189 F. 2d 555 (C.A. 4) (increase from $1.3 to $38 million during 8-year reorganization); *Chemical Bank Co.* v. *Investors*, 343 U.S. 982, 984 (annual earnings of railroad $18 million greater than original estimate); *Knight* v. *Wertheim & Co.*, 158 F. 2d 838 (C.A. 2); *In re Central States Electric Corporation*, 112 F. Supp. 281 (E.D. Va.), affirmed, 206 F.

here, the determination of insolvency is under appellate review, the possibility of reversal on that issue emphasizes the vital interest the stockholders continue to have in this reorganization. The salutary purpose of protecting the interests of public stockholders—who here number approximately 7000—which the provisions for their participation in Chapter X proceedings through committees are intended to serve, would be thwarted if such committees were not permitted to remain in the proceeding until it is finally terminated.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed, and the cause remanded with instructions to (1) vacate the order confirming the plan, (2) vacate the order discharging the Stockholders Committee, (3) conduct hearings on the solvency of the debtor at which time (a) estimates of future earning capacity made in accordance with controlling principles set forth by the Court will be received and considered and (b) financial and other information concerning the debtor's operations and prospects for the future shall be made available in sufficient detail to all the parties, including the Stockholders Committee and the Commission, so that meaningful estimates of future earnings can be made, (4) conduct hearings on the objections to and compromises of the Caplan mortgage and Merrill-Stevens

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2d 70 (C.A. 4); *Standard Gas & Electric Co.*, v. *Deep Rock Oil Corp.*, 117 F. 2d 615 (C.A. 10); *Standard Gas & Electric Co., et al.*, 36 S.E.C. 247, 255.

claims, (5) consider the stockholders' claims based on violations of the federal securities laws on their merits, and (6) prohibit the respondent trustee from becoming president of or assuming any position of importance with the reorganized company.

Respectfully submitted.

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IN THE

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OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner

v.

C. GORDON ANDERSON, TRUSTEE
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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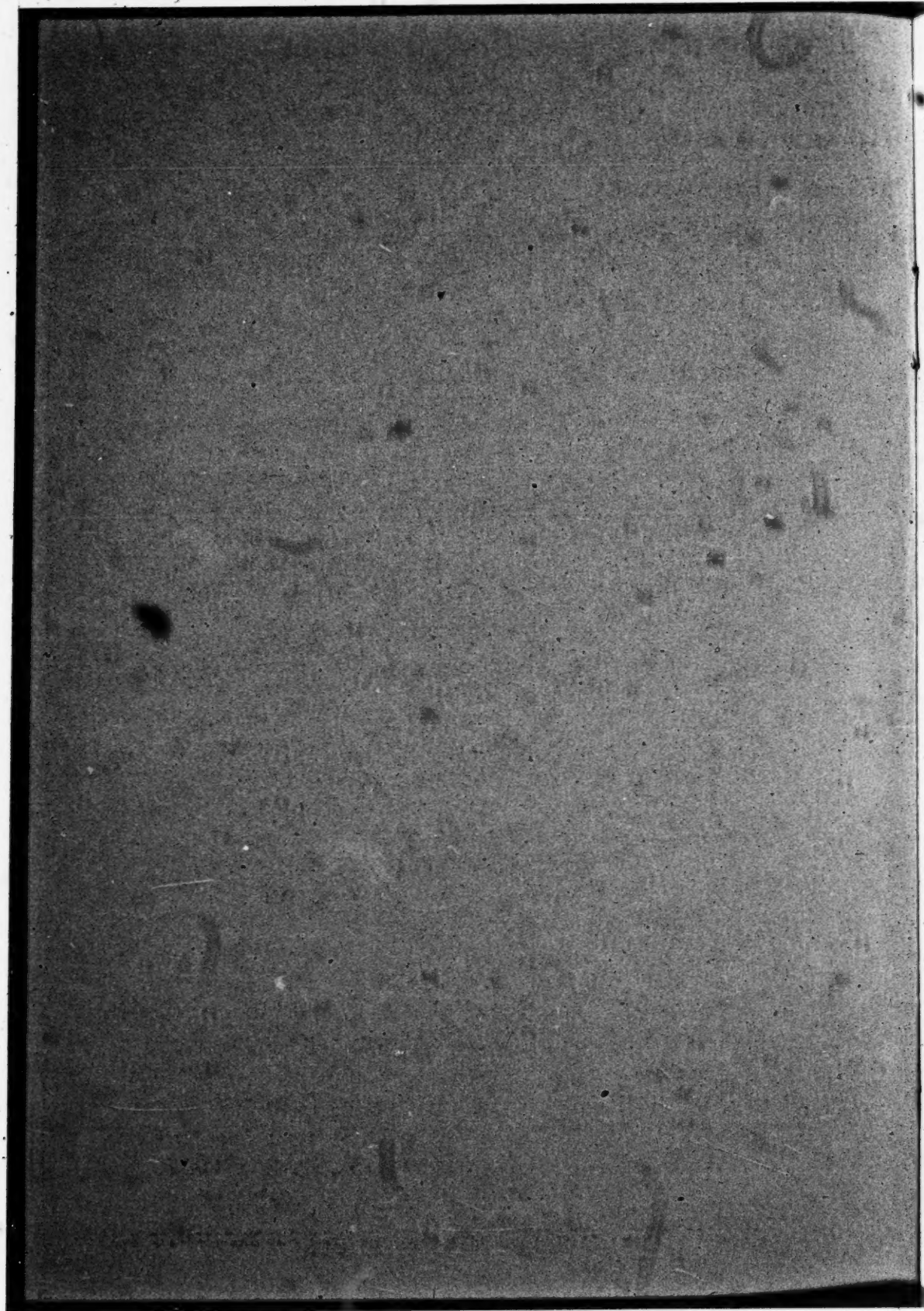

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IN THE

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No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.
Petitioner

v.

C. GORDON ANDERSON, TRUSTEE
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The court of appeals opinion on the third (1965) reorganization plan now under review is reported 364 F2d 936. For its opinion on the first (1959) plan, 292 F2d 355, cert. (by a creditor) den. 368 US 956. For its opinions on the second (1962) plan, 334 F2d 111, cert. (by the trustee) den. 379 US 879; 334 F2d 118. Underlying district court opinions (III 260,387,389; II 370,387)* are unreported.

*Citation conventions: "III", the record, CA5 #22,652, directly involving the 1965 plan of reorganization; "I", the printed transcript

For still earlier court of appeals opinions unrelated to the reorganization plans, 256 F2d 416; 259 F2d 283.

JURISDICTION

The judgment of the court of appeals was entered August 12, 1966 (III 563). The petition for certiorari, filed January 9, 1967 (under extension order by Mr. Justice Black entered November 8, 1966), was granted May 29, 1967. This Court's jurisdiction is under 28 USC § 1254(1) and 11 USC § 47c (Bankruptcy Act, § 24c).

QUESTIONS PRESENTED

1. Whether a Chapter X reorganization plan must be set aside (a) because responsible charges of serious fraud committed by two major creditors have been refused on-the-record § 167 investigation; and because (b) the plan embodies compromises of these creditors' claims against the debtor and of the debtor's claims, setoffs and counterclaims against these creditors, entered into without on-the-record evaluation of the claims compromised, and in one instance without disclosure of the full scope of the compromise.

2. Whether a reorganization plan must be set aside as not "fair and equitable" under § 221(2) because valuation has been determined on past earnings history alone (a) in ex-

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record of appeals on the 1959 plan, CA5 #18,475; "II", the mimeographed transcript record of appeals on the 1962 plan, CA5 #19,996. By stipulation (III,403), I and II were incorporated by reference in III, and have been lodged in this Court under supplemental certificate. Order of this Court entered June 12, 1967 dispenses with record reprinting.

The order of appearance of documents in these three appeal records is not always the order of District Court filing; early filed papers sometimes appear only after later papers, or only in a later appeal record.

plicit rejection of this Court's doctrine that valuation be based on capitalization of predicted post-reorganization earnings; and (b) in consequent rejection of proffered evidence of business facts and reorganization facts tending to show a high immediately post-reorganization earning power of the enterprise; and (c) because even the past earnings history has been distorted by loading with heavy temporary expenses of reorganization and in other ways.

3. Whether public stockholders, who bought their stock in a market fraudulently manipulated by the debtor company in conspiracy with major creditors, may be refused creditor treatment in the reorganization, either (a) on the ground that they have no cause of action against the company as matter of law; or (b) as matter of procedure, on the ground of laches by a finding made without hearing notwithstanding the stockholders' contention was made of record over a year before the finding and three years before the plan now on appeal, and had been acknowledged by the trustee to be meritorious.

4. Whether a reorganization plan that contemplates that the trustee shall become president of the reorganized company must be set aside either

(a) as a matter of law, in that the sponsoring trustee thereby has an inherent conflict of interest that invalidates the required statutory finding that the plan is "fair and equitable" and that it has been promulgated by a "disinterested" trustee; or

(b) as a matter of fact, for actual conflict of interest, e.g., because the plan that puts him in the presidency rests on his compromises with two creditors charged with fraud, whereby the one creditor got a priority and the other got joint control of the reorganized company; or

(c) as a matter of procedure, because of the district court's refusal to allow on-the-record statutory investigation of charges that the trustee's attainment of the presidency involved improper "affiliations" and was therefore not "compatible with the interests of the creditors and stockholders and consistent with public policy".

STATUTES

The principal statutory provisions involved are §§ 167 and 221 of Chapter X of the Bankruptcy Act (11 USC §§ 567 and 621):

Sec. 167. The trustee upon his appointment and qualification—

(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desireability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

* * *

Sec. 221. The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been compiled with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy.

STATEMENT OF THE CASE

This is a corporate reorganization under Chapter X of the Bankruptcy Act. The debtor, essentially sound and profit-making, came into bankruptcy court as a result of stock manipulations and frauds and of an accident at sea which appears to have been caused in part by the frauds.

Three successive plans of reorganization have been approved and confirmed, each over the objections of the stockholders committee and of the Securities & Exchange Commission. Each time the reorganization trustee emerged as president and director of the reorganized debtor, with a long-term contract and stock options firmly promised or transparently understood.

Each time control of the reorganized debtor went to the trustee along with one or another of the insider creditors who had participated in pre-reorganization and during-reorganization frauds. Each time the trustee's refusal to investigate protected an insider creditor and aided the trustee's personal ambitions.

Each plan wiped out several millions of dollars of public stockholder investment as worthless, by insolvency findings made otherwise than by the normal valuation procedure of capitalization of indicated earnings under post-reorganization conditions. This took place first without any valuation hearing and later by hearings confined to reorganization-period earnings. Each of the two later plans rejected without hearing the stockholders' claim to creditor treatment

based on stock frauds by certain of the insiders, disclosed by an investigation reluctantly made between the first and second plans. Each of the three plans provided new management selected without investigation of affiliations.

Pre-reorganization Background[1]

The debtor TMT Trailer Ferry, Inc., organized in 1954, pioneered the novel and sound concept of "fishyback" trailership transportation—roll-on roll-off transport of loaded highway trailers. The essential advantage of the system is that freight moves door to door overseas without rehandling. Initially TMT's trailership service was between Florida and Puerto Rico by barges (converted Navy LSTs) towed by rented tugs. A self-propelled Navy LSD was then acquired for conversion into a trailership. Maritime Administration guaranteed a $4,112,500 construction loan and permanent mortgage for the conversion of the LSD, the Carib Queen, under a statutory determination (46 USC 1274(c) that the operation was "economically sound". Early in 1957 the Carib Queen went into transatlantic service.

In December 1954 a small issue of less than 30,000 shares had been sold (with debentures for a total of less than $300,000) in compliance with the Securities Act of 1933, but in the following two and a half years some 4,000,000 shares of unregistered stock were issued for all kinds of consideration: to pay for ships, repairs and services, for bonuses and finders fees, to acquire stock of other companies, and sometimes for no consideration whatever. Of these shares not quite half were traced as having been floated to the public at prices of up to $4 per share through the hands of a

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[1] Except as otherwise cited, the facts of this "Pre-reorganization Background" rest on stipulation of Agreed Statement of Facts (I 21-43) and Trustee's Report (I 252-295).

group of insiders—Abrams[2] and Shaffer,[3] financial advisors to the company, and an associate, Erdman.[4] The paper assets of the company were increased by an exchange of stock with Bellanca Corp., arranged by Abrams at artificial prices which inflated by $800,000 the balance sheet on which Maritime Administration relied for the purpose of the Carib Queen loan guarantee. There were other shady Abrams transactions, including TMT's acquisition of wharf property at Wilmington, Delaware, for $1,000,000 above its true worth on the strength of an appraisal fraudulently procured over the name of a leading appraisal firm.

The illegal stock flotation and resulting large profits for the members of the group (over $240,000 established for Shaffer and his wife alone) were the product of an intense stock-selling campaign based on the "fishyback" method of transport, the launching of the self-propelled Carib Queen and the Maritime Administration guarantee.

The conversion work on the Carib Queen was done by Merrill-Stevens Drydock & Repair Co., ultimately the largest single creditor with claims totalling over $1,600,000 mostly for work on the Carib Queen. On the shake-down voyage there was boiler trouble (II 1055-6,1065-6,1099-1100;III 407-8). Merrill-Stevens had notice of the fact that the boiler water supply system left excessive oxygen in the water, and this made the boiler trouble that actually occurred, in its own word, "inevitable" (II 1062). Repairs were made

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[2]During the reorganization Abrams was convicted of contract fraud on the government and securities fraud in another company, I 258; Facts on File 1961 – 31D2; N.Y. Times Index 1964, p970; for related frauds by Abrams, *Ashbach v. Kirtley*, 289 F2d 159 (CA8,1961), *Kirtley v. Abrams*, 299 F2d 341 (CA2,1962), discussed infra p. 33.

[3]Shaffer was manager of a branch office of the reputable brokerage firm of Hirsch & Co. His transactions were partly in the name of his wife, Pauline Golding.

[4]Dr. Erdman was later convicted of bribing a federal judge in a bankruptcy case, N.Y. Times Index 1962, p510; ib. 1964, p510.

and the ship was released for her maiden voyage to Europe. In mid-Atlantic the boilers exploded.

In June 1957, Abrams and Shaffer knew bankruptcy was impending. They put together a group under the name of a strawman, Caplan, and furnished fresh money. (Caplan was later replaced by Shaffer and Spitzer so that the group is indifferently identified as the Abrams-Shaffer-Erdman or Caplan or Shaffer-Spitzer group.) They paid $280,500 for a $330,000 7-months note secured by a mortgage on the barges (plus 10,000 shares of bonus stock), and $49,500 for 49,500 shares of stock, market value then over $60,000. This short-term mortgage thus gave these insiders in the event of bankruptcy a strangle-hold on the only operating vessels. Within the month, on June 27, 1957, an involuntary petition under Chapter X was filed. The petitioner Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. entered the case under § 211 of the Act shortly after the proceeding started in mid-1957. The Securities & Exchange Commission, a party under § 208 of the Act and advisor under § 172, has been participating in the proceedings since November 1957.

The first Plan: control to Shaffer-Spitzer without investigation of fraud charges; stockholders eliminated without valuation hearing: – The insiders succeeded in using their eve-of-bankruptcy mortgage to gain control under the first reorganization plan. Ignoring his own objections to the mortgage as "usurious, unenforceable and void" (I 34), and brushing aside demands by the committee and the SEC for investigation of the frauds and of indications that the Caplan (Shaffer-Spitzer) mortgage group were fronts for the Abrams-Shaffer-Erdman fraudulent insiders (I 128-134, 179-181, 203, 463-467), the trustee "settled" with the mortgage group. The district court confirmed a plan of reorganiztion under which the Shaffer-Spitzer group, for its $280,500 payment, got all the voting stock of a company earning nearly that each year; general creditors received 17½ cents on the dollar out of one quarter of the earnings (I 163-5). The trustee became president and a director, with stock options (I 183, 198; II 525). The stockholders were wiped

out by an insolvency order entered without notice or hearing (Stip. I 34; 171, 444-5, 462-3). The Committee appealed, attacking the lack both of investigation and of proper insolvency proceedings (I 206).

Pending appeal, an interim trustee discovered a $100,000 under-the-table side deal by which Shaffer-Spitzer turned Merrill-Stevens' initial opposition to the plan into acceptance. His attempt to get the district court to vacate the plan as thereby violative of § 221 of Chapter X was unsuccessful although supported by the SEC, by a major creditor Tri-Continental Financial Corp., and by the committee (I 39-40,195-203;236). The district court refused to vacate the plan, removed the interim trustee and reinstated the prior and still-serving trustee (I 39-41).

The reinstated trustee, deriding as "frivolous" the committee's objections and appeal and pushing for immediate consummation (I 210,213), was confronted with affidavit proof presented by the SEC that Abrams and his associates were the owners of the Caplan mortgage[5] and were responsible for the Bellanca, Wilmington and other fraudulent transactions (I 216-230). At this point, reversing his course 180°, the trustee dutifully conducted an investigation of this portion of the frauds charged by the committee, fully corroborated them (I 252-295)[6] and moved to withdraw his own plan of reorganization as not fair and equitable (I 294-5;307-8,325-6). The district court granted the motion, Shaffer-Spitzer appealed, and the court of appeals affirmed. In view of the withdrawal of the plan the court of appeals considered the committee's appeal to have become moot,

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[5] Under various cover names, one of which was Bostwick Westbury Corp. whose address as given in the mortgage instrument was reported (correctly, it turned out) to be identical with Abrams' home address in Great Neck, Long Island. The committee had pointed out to the trustee and district court that this simple inquiry would corroborate the committee's charges of Abrams' connection with the mortgage but the trustee and the court refused to investigate (I 180).

[6] The trustee's report of this investigation is the report referred to supra n. 1 as record support for the opening pages of this brief.

and the proceedings returned to the district court for formulation of a new plan. *TMT Trailer Ferry, Inc. v. Anderson*, 292 F2d 455 (CA5), cert. (by Shaffer-Spitzer) den., 368 US 956.

The second plan: control to Merrill-Stevens without investigation of fraud charges; priority to Shaffer-Spitzer without remedy for proven fraud; stockholders eliminated by retrospective valuation: – The Merrill-Stevens claims arose principally out of services in the design and construction or conversion of the debtor company's vessels. The "Lloyd", designed and built by Merrill-Stevens, proved top-heavy and capsized (II 1069;III 410; but see 1098 ff); the "Georgia", converted by Merrill-Stevens, put to sea with open discharge lines and swamped (II 1068,III 409; but see 1098 ff); the "Carib Queen", converted by Merrill-Stevens under Maritime Administration guarantee, was released with defective boilers which exploded in mid-Atlantic (I 271;II 1045 ff;III 406-9, but see 1098 ff). Damages amount to millions of dollars (I 270).

Merrill-Stevens asserted an unsecured creditor claim of over $1,000,000 for balance due on the Carib Queen (foreclosed by Maritime Administration as guarantor, supra p. 6) and maritime lien against other vessels for $575,000–together $1,628,000 out of total creditor claims of $5,400,000 (II 23,288).

As early as November 1958, i.e., before approval of even Plan I, the committee had sought investigation of Merrill-Stevens responsibility for losses (I 130). The trustee filed what he later denigrated as "perfunctory" objections to the Merrill-Stevens claim (II 23). On February 3, 1959, neatly one day after the Shaffer-Spitzer $100,000 under-the-table purchase of Merrill-Stevens acceptance of Plan I (I 39, 200-3; supra p. 9) trustee's counsel announced at a special master's omnibus hearing on objections to claims that the Merrill-Stevens claim had been "accepted and settled out of court" (II 23-4).

After vacation of Plan I the trustee reported the claim as informally settled (II 621-2). The SEC objected and asked

for investigation on the ground that the trustee did not have enough information to arrange a fair settlement; that the claim was excessive, the work unsatisfactory, the Carib Queen not seaworthy (II 24,1094-5). The SEC detailed in Specifications the results of its own investigation. It concluded that defenses, offsets and counterclaim were available against the balance claimed on the Carib Queen; that Merrill-Stevens was responsible for damage and loss, including cancellation of a U.S. government mail contract because of construction and registration delay of the "Lloyd"; that reduction of claims against "Georgia" and "Carolina" was called for (II 25,862; III 405). Merrill-Stevens answered with a document of broad denial (II 1098), but no hearing on the Specifications was ever held.

Instead the trustee moved for full allowance of the claim notwithstanding the SEC objection.[7]

The U.S. government, a major creditor, also filed objections (II 647). The committee then submitted Specifications of its own investigation (II 1042-1072.4), charging negligence and contract breach, based on detailed analysis of the contracts, of the records, and of admissions made by Merrill-Stevens employes. The Specifications particularized the contract paragraphs, the evidentiary documents and the witnesses whose recorded statements are relied on, with names and dates. The Specifications also supplied evidence of Merrill-Stevens participation with the debtor and Shaffer-Spitzer in the marketrigging, including fraud on the Maritime Administration by Merrill-Stevens and the debtor in obtaining the highly publicized loan guarantee on the Carib Queen, and asked a master's hearing. The SEC advised the court that the burden of proof and of rebuttal was now on Merrill-Stevens and also requested the district court to order a hearing on the committee Specifications (II 1073-4). Merrill-Stevens made no answer; no hearing was ordered on these Specifications.

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[7]The effect of this capitulation is argued infra p. 28 ff.

Instead the Merrill-Stevens claim was "compromised" in Plan II by allowance in full to the penny—$1,628,284.40, after reclassification to unsecured position of the $575,000 lien, already under attack by the U.S. government as an invalid maritime lien.[8] Thus, by cumulation of its dubious claims, Merrill-Stevens became the largest (ca.43%) of the unsecured creditors, the class that got the voting stock, and so came into control (2 places on a board of 7)[9] along with the trustee himself and his general manager (II 297-8) and one of his attorneys (II 978,III 354). The remaining two directorships went to beneficiaries of the trustee's reorganization patronage (and therefore of his post-reorganization patronage, if they did not newly offend him). One was an official of the towing company[10] that held a sweetheart contract running to $1,500,000/year,[11] bestowed without fair opportunity for competitive bidding and at a price per voyage $1,000 higher than an actual bid received (II 946-954; III 94-6). The other was the trustee's insurance broker (III 353-4), like the towing family a heavy buyer of creditors'

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[8] In the circumstances of this reorganization, reclassification to unsecured was not a demotion but in fact, as the trustee's general manager admitted, a "privilege" (III 91). Florida Towing, with an undisputed lien claim, elected to make the same swap and for the same purpose, viz., to get a piece of control (II 878,879.3,987).

[9] The next largest general creditor, Tri-Continental Financial Corp. with $715,000 of claims, well over a seventh (cf. III 323), was not represented on the 7-man board.

[10] Florida Towing, one of three towing companies that did pre-reorganization work for the debtor, was originally a small lien creditor. With its principals the Coppedge family (II 917;III 353), it brought up claims and became a major creditor (II 879.3,354.10;III 317 ff). Florida Towing also supplied a loan commitment tied to the trustee's plan and "present management" (II 321) without which the plan could not be effectuated (II 313,320-3,903-4). The words of the loan commitment were later changed to "either present management (which is acceptable to us) or management of comparable calibre" (II 749-50).

[11] Towing is the largest single item of expense. See, e.g., II 219; III 76.

claims at large discounts (II 261,867,911,938;III 322). The trustee was again to be president and director (II 695,707, 978,987) with a long-term contract and formal assurance (or in later bowdlerized versions, practical assurance) of substantial stock options (II 274,276-7,296-9; 41.11)[12]

The committee's new and unanswered charges of collusion in marketrigging by the debtor and Merrill-Stevens bore on the Shaffer-Spitzer principals too (II 1066-7) since they were the active marketriggers, proven such in the early proceedings. Nevertheless the second plan embodied a "compromise" with Shaffer-Spitzer, that gave them a priority claim plus back interest plus a concealed immunity from suit.[13]

As in the first plan, the several million dollar stockholder investment was eliminated on an insolvency finding, though this time by a procedure that at least included a valuation hearing. Based on the conception that "the only reliable factors are what the debtor is doing now" (II 387.7), the court's valuation of $2,780,000 was arrived at by annualizing the trustee's then current (5-months) profit figure, deducting estimated taxes and capitalizing at 10% (II 387.5).[14] Before confirmation, two competing cash bidders had reached a level of $2,800,000, viz., more than the court's valuation, and indicated they were ready to go higher (II 865-6,876,880,911, 913,938,939). Essential information was excluded from the

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[12]The effect of such self-perpetuation by the trustee as invalidating the plan (Question 3, supra p. 3) is argued infra p. 62.

[13]The effect of this compromise (Questions 1 and 4, supra pp. 2-3 is argued infra, p. 29.

[14]The question whether the valuation technique which considered past earnings only, without consideration of an already existent current trend of increased traffic and of the trustee's already existent physical and financial programming to serve it at increased earnings after reorganization, departed from the standards laid down by this Court (Question 2, supra p. 2) is argued infra p. 42ff.

valuation hearings, and reported earnings were downwardly distorted.[15]

After the collapse of his first plan the trustee had proposed to prepare a new plan that would "satisfy the equities" indicated by the investigation (I 295); that as a result of TMT's securities laws violations instigated by Abrams and Shaffer (now d/b/a the Shaffer-Spitzer mortgagees) victimized stockholders were entitled to be regarded as creditors and in any case to participate ahead of Shaffer-Spitzer (II 1096). The trustee's report had showed the company's collusion with Abrams and Shaffer in securities law violations.[16] This led to the assertion by the committee, in proceedings looking toward a second plan but before remand on vacation of Plan I, that defrauded stockholders were entitled to be treated as general creditors (II 1037-42,[17] 1083, 1087, 1090;358,368).

No response was ever made to the Proof of Claim on this point filed by the committee; a motion to strike the Proof of Claim filed by an individual stockholder[18] on behalf of herself and her class of stockholders, which traced her shares of stock as having come through Abrams' hands, was never noticed for hearing (II 4,363,358,368). Nevertheless the district court's order approving the second plan summarily denied the claim in both forms without hearing, as insufficient on the merits, nebulous and too late (II 379).[19]

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[15] This aspect of the valuation is elaborated infra p. 55 ff.

[16] Including flotation of stock to the public through Abrams and Shaffer, publication of deceptive and grossly padded financial statements, improper transactions with Abrams and Shaffer, fostering of a speculative market by excessive publicity campaigns and other manipulations (I 260-286,288-9).

[17] The citation is to the committee's Statement of Position, served and proferred March 21, 1961; leave to file denied without prejudice to renewal (II 861,962); filed pursuant to leave as a rejected exhibit April 15, 1963.

[18] Irma S. Mason of the District of Columbia bar, of counsel on this brief.

[19] This question of the stockholders' right to creditor treatment (Question 3, supra p. 3) is argued infra p. 55ff).

The SEC supported both the principle of the claim and a right to hearing on the merits (II 1093).

The appeals from the second plan: – The committee appealed from confirmation of the second plan, asserting that this plan embodied the same aberrations of principle challenged in the first appeal but there left undecided, i.e., off-the-record compromise without on-the-record investigation of claims of insider creditors accused of fraud; grossly erroneous valuation technique. The committee also raised two additional issues arising out of the facts that had developed since the first appeal–the trustee's conflict of interest arising out of his interlocking alliances with the new control creditors; the stockholders' right to creditor treatment. The SEC again joined in the committee's appeal, taking as to the trustee the even more rigorous view that he was disqualified as president for prophylactic reasons quite apart from the actual proof of improper affiliations.

The U.S. as creditor also appealed because of denial of its absolute priority for certain non-tax claims. The court of appeals, sustaining the government, reversed and remanded. *United States v. Anderson,* 334 F2d 111, cert. (by the trustee) den. 379 US 879. Because a remand was thus necessary, the court of appeals again found it unnecessary to decide the issues raised on the stockholders' appeal except for advisory guidance on one point, that the trustee was not ipso facto disqualified from the presidency, although he would be "if the proponents of the plan assured him of emoluments and security", *In re TMT Trailer Ferry, Inc.,* 334 F2d 118,119,120.

The third plan: priority again to Shaffer-Spitzer and control again to Merrill-Stevens, the stockholders again eliminated; all by "law of the case": – Immediately on the opening of hearings on the third plan, renewing its charges against Merrill-Stevens, the committee asked for discovery of a group of documents that the trustee had earlier said he could not locate (III 19-20;85, cf.II 1072.3-.4). The district court refused this discovery on the ground that the at-

tack on Merrill-Stevens—and every other issue raised by the committee in the second appeal but left undecided by the court of appeals—had thereby been decided by the court of appeals against the committee, and were now the law of the case (III 85-87,264,350-1, 387-9).

As recited infra, p. 17, the court of appeals was to hold, on the committee's appeal from the third plan, that it had indeed contemplated no such thing as the district court attributed to it. But the district court's erroneous conception of the law of the case aborted the making of the record on the third plan: that court refused to consider the committee's demand for investigation of trustee affiliations (III 244-5;264) and confined the valuation proceedings to facts occurring since the second plan (III 66-7). Its new valuation found the debtor "more insolvent" than before without consideration of the committee's and the SEC's claim of error in the techniques used by the district court in both stages of valuation alike (III 266).

In a culminating application of the erroneous conception of law of the case—and in obvious pique at what the district court deemed the committee's obstructionism—the district court summarily discharged the committee for its recalcitrance in persisting in reraising this mess of issues the district court deemed closed; and so the denial of the committee's application for discovery of the Merrill-Stevens documents just mentioned was coupled with an oral order from the bench discharging the committee instanter (III 350-1, 387-9).

The trustee proposed and the district court accepted a third—the present—plan, differing from the second plan mainly in granting the government's non-tax claims a priority in the form of a cash payment of $904,000, financed out of a $1,250,000 new bank loan (III 25,107-8,347).[20]

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[20] At the time of the second plan the district court accepted the trustee's contention that cash payment to the government would

The third (present) appeal: – On the appeal from Plan III the court of appeals held that the district court's conception of the law of the case had been in error: the district court, in making the record and confirming the plan in disregard of the stockholders contentions, had incorrectly foreclosed "all those issues not in terms discussed and decided" in the earlier appeal, 364 F2d at 939. Nevertheless the plan was allowed to stand and the stockholders were left without remedy for the fact that this district court error resulted in presenting the plan for appeal on an erroneously aborted record.

The ground for the court of appeals action in so affirming in spite of the error was, that court stated, as to the stockholders' assertion of creditor rights, that it was within trial court discretion to set a bar date and find the stockholders in laches. On the compromises with insiders notwithstanding fraud charges, the court of appeals did not discuss the merits but found it "extremely significant that not a single creditor has ever complained of either compromise". It affirmed the insolvency determination on the ground that the district court's valuation mathematics was not demonstrated "clearly erroneous"; even if the $2,000,000 of the Merrill-Stevens and Shaffer-Spitzer claims were to be stricken the court of appeals thought it "extremely unlikely" that this would result in solvency. It did not discuss the committee's contention that this gap reflected only

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have made the plan of reorganization not feasible (II 373-4,765,825). The fact that the new bank loan requires debt service ($300,000 a year plus interest at 6%, or $366,750 the first year (III 347-8), in excess of the trustee's and the District Court's earnings estimates ($206,000 (II 387.3)) or $378,000 (II 387.5) on which valuation was based), is discussed infra p. 54, 62, as bearing on whether the plan is in good faith, and whether the trustee's earnings figures are realistic, and on the effect of the trustee's affiliations.

the erroneous rejection of evidence that this Court's decisions have required to be included and considered.[21]

In the light of the court of appeals treatment of the case as involving the presumption of correctness of trial court action unless "clearly erroneous" and of deference to trial court "discretion" there runs through all the specific rulings of the court of appeals a common question of essential fairness—whether trial court failure to permit the making of a record, on the issues of laches and valuation and fraud to say nothing of the tainting of the whole proceeding by a trustee's conflict of interest, is error too gross to be saved as within "discretion" or as "not clearly erroneous".

SUMMARY OF ARGUMENT

Petitioner is a committee representing public stockholders. These stockholders are, unless this Court intervene, to be deprived forever of any salvage for their investment of several million dollars in favor of the very persons they challenge as responsible for the destruction of their company. (Point I)

This results, in one major branch of the case, because the courts below found an unbridgeable gap between the minimum figure for claims, $3,400,000; and the maximum figure for the value of the enterprise (which in the year of the valuation, had revenue of $3,800,000 and profit of $655,000 before taxes). The district court fixed the maximum value of the estate at $2,780,000.

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[21] This contention (Question 2, supra p. 2) is argued infra p. 42 ff. On this third appeal the court of appeals did not discuss at all the retendered point of the trustee's emergence as president (Question 4, supra p. 3). The point is still open for review in this Court now, since it was the affirmance of the third plan that for the first time ripened the court of appeals own explicit but advisory second plan decision on that point. Stern & Gressman, *Supreme Court Practice* (3d ed., 1962) 18.

Valuation is an uncertain art at best, but it has standards. This valuation was based on rejection of all evidence of predictable higher revenue and predictable lower costs for the reorganized company, in explicit repudiation of this Court's standards requiring valuation to be measured by future earning power, e.g. *Consolidated Rock etc. Co. v. DuBois,* 312 US 510; and it was immediately proven fallacious. Even as the district court announced its $2,780,000 figure, responsible but uninvited prospective buyers in a brisk bidding that rose by small increments to successively top the trustee's and court's values, offered in cash more than the court's official valuation, and made clear that that was not their top figure.

These unsolicited bids demonstrated, by the test of the market place, the irreality of the district court's valuation. Confronted by this proof, the district court failed to reexamine his conclusions and failed to test out the level to which the market would go. It is inescapable on these facts that a valuation reliable enough to justify excluding the stockholders has never been made (Point II).

These errors do not stand alone. The trustee has refused investigation into pre-reorganization wrongdoing it was his statutory duty to expose. And he has made illusory compromises with the accused wrongdoers, surreptitiously agreed to abandon substantial causes of action against some of them, made alliances with them and with other major creditors that put control of the company into hands which the policy of Chapter X forbids, those responsible for the destruction of the company and discount purchasers of claims who used those claims to vote themselves into shares of control and post-reorganization patronage.

All this involved essentially application of what is now hornbook reorganization law. It has place on this Court's docket primarily because the multiple procedural violations by the trustee have been coupled with his flouting of the overall fiduciary responsibility imposed by the statute, *Wolf v. Weinstein,* 372 US 633, and because he has been encour-

aged in recidivism by the failure of the courts below to grasp the twice before offered opportunity to enforce that responsibility. These very issues were raised but not decided, on the committee's appeals from two earlier plans involving much the same complaints. (Points I and II)

The plan on appeal should be invalidated for two further reasons, which the case law has not so far brought before this Court:

First, stockholders who have been defrauded by a conspiracy, in which the company participated, to issue stock in violation of the Securities Act of 1933 and to float it to the public in a market manipulated in violation of the Securities Exchange Act of 1934, are entitled because of such violations to be treated in a Chapter X reorganization as creditors, quite apart from solvency. The facts were first disclosed in 1960 and the claim first asserted of record in 1961. The court of appeals avoided passing on this issue by disposing of it on the ground that it was raised too late. But this was in turn major procedural error, for the question of alleged lateness was one of fact and was disposed of without hearing. *Czaplicki v. The Hoegh Silvercloud*, 351 US 525. (Point III)

Second, the trustee's accession to the presidency under this strongly contested plan as under each of its predecessors establishes that it has not been promulgated by a "disinterested" trustee as the statute requires, and that the plan must therefore be vacated. We join the SEC in believing that a rule so excluding any trustee is a healthy one required by the policy of the statute. This broad question is not however necessarily involved in our case because, whether trustees generally should be so barred, this one must be. It is impossible here to disentangle the concurrence of his personal ambitions with his violations of basic reorganization protections. (Point IV)

In a case as long and as complex as this it is not feasible to pursue and analyse to the full each of the myriad issues that are involved. For that reason we shall necessarily treat

rather summarily many points individually worth close attention, pointing out only that, shocking though our charges are, they are in fact fully supported by the record; and through ten years of litigation and three major rounds of appeals, our positions on these points have been consistently supported by the only wholly expert, wholly independent, wholly disinterested party, the SEC. (Point V)

ARGUMENT

The reorganization process was house-cleaned in the nineteen thirties by a series of reforms designed to protect the investor interest against insiders and adventurers. The chief weapons were to be investigation and disclosure by an independent trustee, under the active control of the district court aided by an expert administrative agency, with representation of scattered security-holder interests made possible by fiduciary committees.

The spirit of the legislation was stated by then SEC Commissioner Douglas as follows:

> "There is a widespread and national interest in these reorganization proceedings. . . . The holdings are small and individual action by the stockholders to protect themselves is in many cases out of the question. They either lack the funds or the skill, the acumen or the initiative to take matters into their own hands. They are frequently without adequate representation in the proceedings. . . . They are at the mercy of the inside groups—management and bankers—. . . and these inside groups often have objectives which are incompatible with the objectives of investors. They are interested in concealing claims for fraud or mismanagement; investors are interested in collecting on these claims. They are interested in keeping the past a closed book; investors are interested in examining the past to determine whether or not the management has been incompetent or faithless . . . they are interested in reorganization profits;

> investors are interested in economy and fairness . . . . The problem becomes one of making it more probable that the investor interest will be ascendant and dominant and that reorganization adventurers will not exploit the proceedings for their own selfish objectives." *Hearings before H.R. Committee on the Judiciary on H.R. 8046* (75th Cong. 1st Sess.) p. 163-4.

Roughly thirty years later, the benefits of that reform need to be looked at again. This case affords a conspectus of the abuses recognized in the thirties, densely packed into a single record.

POINT I—The failure of the district court to require the trustee to make the investigations and disclosures required by Chapter X resulted in withholding from the record essential facts: in consequence, insiders were enabled to gain control of the debtor company and stockholders were unfairly excluded.

If Chapter X is to achieve its purpose, "Reorganization facts should not be shrouded in mystery." SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Part VII, p. 341 (1940). The Chapter X procedure was designed, notably in sections 167 and 221, to give assurance that the past would be investigated and not hidden and that parties to the reorganization would have access to the facts they need for intelligent appraisal of the future.

> "For the first time such information will be available to the court and the investors as a routine matter. On the basis of such information, the court and the investors can intelligently decide whether or not proposed plans are fair, equitable, and sound—whether assets are being wasted or overlooked; whether there is a complete accounting for the old venture before the new one is launched; whether the old management should be restored to power; whether the allocation of assets, earnings, and control are fair. Through an impartial trustee, such facts will be assembled and

appraised" (H. Rep. No. 1409, 75th Cong., 1st Sess. (1937), p. 43).

A. Investigation of pre-reorganization misconduct, required by Chapter X, was delayed or suppressed.

Certain investigations are mandatory. The trustee has not made them and the courts below have not required them.

Investigation of responsible charges of fraud is one of them. § 167(1) requires that the trustee investigate the "acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan." There is a special emphasis that he shall report the facts that he learns "pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate," § 167(3). No plan may be confirmed unless the judge is "satisfied" among many other things that § 167, as part of Article VII of Chapter X has been complied with. § 221(1).

At the risk of elaborating the obvious it should be remarked that this requirement that the reorganization judge be "satisfied" is not a formalism: it is intended to spur him to aggressive ascertainment that the standards of the statute have been met. 6 *Collier on Bankruptcy*, ¶ 11.02. The legislative history collected, ibid. ¶ 7.18, makes plain that although § 167 is discretionary in form—the trustee "shall, if the judge shall so direct, forthwith investigate"—it is normally mandatory in fact. Whenever a substantial question of fraud is raised, a searching examination is required:

> "The independent trustee should be authorized and directed to make an investigation in every case of the condition of the company and of the events antedating the failure . . . an investigation of the most complete and thorough-going character, with opportunities to examine under oath those who had knowledge of the corporation's affairs and with the institution of suits for recovery where probable liability had been shown, *to the end that all the processes of*

discovery provided by law might be fully used. This requirement was not met by the sort of examination which the trustees conducted", *Committee for Holders etc. v. Kent,* 143 F2d 684,686 (CA4, our emph.)."

"The duty of the court to direct the investigation of all substantial allegations of mismanagement and fraud is plain." *Re Phila. & Reading etc. Co.,* 105 F2d 354,356 (CA3)." See also *Gochenour v. Cleveland Terminals Blg. Co.* 118 F2d 89 (CA6); *In Re South State Street Bldg. Corp.,* 105 F2d 680 (CA7)

It was a failure of investigation that led to the vacation of the first (1959) reorganization plan for TMT. That plan had turned the company over to the Shaffer-Spitzer mortgage group, notwithstanding the committee had made charges that the group was a cover for the notorious Abrams who had been largely responsible for wrecking the old company. Trustee and district court declined to investigate, and the court instead confirmed the plan: the committee appealed. When the trustee insisted that the plan be consummated notwithstanding the appeal, the SEC presented a staff affidavit that corroborated the committee's charges. Only then did the trustee himself investigate, confirm the charges, withdraw the plan, and recommend remedial measures.

One would think the trustee had learned an important lesson.[22] But he did not learn it. He has never carried out

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[22] The lesson to be learned is best stated in his own language, quoted from his court of appeals brief in the Shaffer-Spitzer appeal (#18475) from vacation of Plan I, pp. 4,9,49,50: "The cause of these appeals is indeed unusual: the determination made by the trustee after a lengthy investigation that his plan of reorganization was not fair and equitable, and the court thereupon setting it aside so that he might come up with a better one for all concerned. * * * [T]hese proceedings [to determine the amount and priority of all mortgages and liens] were never had because the trustee and the lien claimants "agreed" as to the disposition of liens in the plan of reorganization. It is apparent now that it was unwise to proceed in such a hurry in an effort to get some kind of plan approved, by-passing the statutory provision for an investigation and

his own remedies as to Shaffer-Spitzer. Moreover, when a parallel situation presented itself as to Merrill-Stevens on Plans II and III, the whole process was repeated.

Twice plans of reorganization have been approved and confirmed giving control to Merrill-Stevens and the trustee (II 370, 881, 987; III 260, 328, 353) without investigation of challenges to the claim and responsible charges of misconduct and fraud. The committee initially charged negligence (I 130); the U.S. as creditor challenged the validity of the asserted maritime liens (II 647). The SEC made an investigation and specified defenses, offsets and counterclaim available against the entire claim; (III 405) these Specifications were met by a document of broad denial (II 1098). No investigation of counterclaims to Merrill-Stevens claims or setoffs and defenses has ever been made on the record. Unnamed assistants disposed of all these issues off-the-record on no basis more articulate than that Merrill-Stevens did not choose to yield to the trustee's request to compromise.[23]

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for a proper valuation proceeding in a reorganization of this size and complexity * * * [S]ubsequent events have justified the stockholder's position and that the plan of reorganization should not have been approved and confirmed without the formal trustee investigation contemplated by the Bankruptcy Act and without formal insolvency proceedings. * * *"

[23] The trustee's articles of surrender took the form of a motion, December 27, 1961, to allow the Merrill-Stevens claim in full:

"8. Efforts have been made by the Trustee to effect a compromise with Merrill-Stevens of the amount of its claim in view of the objections filed against it, but Merrill-Stevens has refused to make any compromise and insists that its claim be allowed in full. It is the opinion of the Trustee and of his undersigned counsel that further effort to compromise or settle this claim will not be successful.

"9. Two attorneys in the office of counsel for the trustee have examined the factual data gathered in the trustee's investigation of the objections to the Merrill-Stevens claim and it is the considered opinion of both attorneys that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it. Trial of the issues

The committee, dissatisfied by this casual treatment, obtained leave of court for further study, and six weeks later filed thirty-odd pages of detailed Specifications resulting from its own investigation. (II 1042-1072.4). Here the committee reported additional items of negligence and contract breach, documented with specific evidence including identification of admissions by Merrill-Stevens and its employees.[24] The committee also reported strong indications of Merrill-Stevens' participation in the stockrigging conspiracy, including deception of the Maritime Administration. (II 1071-1072.4) The committee's Specifications stand unanswered in the record, although the SEC advised the court that these Specifications shifted the burden of going forward to Merrill-Stevens and that a hearing should be held. (II 1073). No hearing was ever held on them. The committee's specifications acknowledged a gap in its proof on the fraud issue because of lack of the file on the Maritime Administration guarantee (II 1072.2-.4) which the trustee advised he did not have (III 19-20,85).

The committee then made further diligent investigation, attempted fruitlessly to obtain an administrative ruling permitting or declining voluntary production of the Maritime Administration counterpart file; and when a ruling finally came down in November 1964 refusing to disclose the documents in the absence of a court order the committee applied to the district court in December 1964 for a production order (III 16). Production was denied (III 73,87). The committee by further effort then succeeded in pinpointing individual documents, contents, dates, and file numbers. Its renewal of the same attempt at discovery by Rule 36 request for admissions was also denied (III 310,346,351). Both de-

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raised by the objections would be time consuming and would result in unnecessary delay in formulating a plan or reorganization." (II 25-6)

[24] Thus, James Merrill confirmed that the turbines of the Carib Queen were not chemically cleaned, II 1054-5. Forbell of Merrill-Stevens admitted that the evaporator producing distilled water for the Carib Queen was inadequate II 1059. Merrill-Stevens acknowledged that, because of excessive oxygen content in the water, it "knew that boiler troubles of the type that occurred were inevitable" (II 1062).

nials rested on the pervasive and mistaken ground of law of the case, that precluded consideration of so many of the committee's contentions at the time of Plan III.

Lacking these documents the trustee could not have made even informal investigation of the committee's charge of collusion between TMT management and Merrill-Stevens. A conscientious trustee would have been ashamed not to follow up these leads. Proof of such collusion, apart from its impact on the question of future control, could benefit the estate in many ways. For example, it would allow recovery against the Shaffer-Spitzer principals for any damages the company suffered by actions of Merrill-Stevens pursuant to the stockrigging conspiracy, a matter of some importance in the event that Merrill-Stevens might not be able to respond to judgment (Cf. II 1066). The Specifications themselves had pointed out that such proof would also completely cut the ground out from under the only defense Merrill-Stevens had so far presented on the record to meet its admissions as to the Carib Queen—the notion that TMT management had known of the deficiencies of the vessel and had condoned them. (II 1062).[25]

In sum, then the decision not to pursue Merrill-Stevens, made before the committee Specifications were filed, took no account of substantial charges never denied, of significant admissions against interest, and of new documentation never examined by the trustee. Investigation and hearing on its challenged claim and on the fraud charge having been thus suppressed, under Plans II and III Merrill-Stevens and the trustee came into control.[26]

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[25] The committee's Specifications, however, had also met this defense on another ground, viz, that the construction contract had been so drawn as to preclude just such fuzzy parole proof of condonation, for it included the elementary requirement of any competently drafted construction contract, viz, a specific and detailed procedure of formal and written warning and disclaimer of liability by Merrill-Stevens to TMT (II 1051-2).

[26] Merrill-Stevens' control position is further discussed, infra, pp. 28-9.

B. Unfair compromises were made by the trustee with the two dominant creditors without disclosure of the true terms of one or the basis of either compromise.

Instead of investigating the fraud charges as to the Merrill-Stevens claim the trustee disposed of the claim by purported compromise in both Plan II and Plan III alike.

The "compromise" allowed the claim in the full amount, $1,628,284.40, with no discount at all for the indicated defenses and counterclaims for negligence and contract breach nor for the wholly uninvestigated question of fraud. The only modification between claim and plan treatment was that, on the one-third or so of the claim, $575,000, for which it asserted a (disputed) maritime lien, MS waived priority.

While this reduction from lien rank to parity with general creditors might serve as the traditional peppercorn to make consideration for a bargain, this does not make the deal any less of a surrender by the trustee. In the first place, the $575,000 face value figure for the lien claim was never its enforceable value for lien purposes: it was secured by assets having a value of less than half the total lien claims against them (II 7, 736-7), as the district court recognized (II 372), so that the resulting deficiency of more than half the $575,000 could not hope to get more than unsecured status under any possible marshalling. At that, other creditors had advanced detailed objections to the validity of the lien on grounds of maritime law, and these issues had never been examined (II 636,647,648-9).

What destroys any claim that this deal might have to recognition as a compromise in good faith, however, is the fact that when Merrill-Stevens swapped the lien claim for general creditor status it not alone sacrificed nothing real but gained something very real – control. Merrill-Stevens thereby became overwhelmingly the largest single general creditor, increasing its fraction of that class from less than 30% to over 40%. Since it was general creditors that got

the voting stock, and the remaining general creditors were sufficiently scattered that no three of them could now outvote it (III 318), Merrill-Stevens now had initial working control of the reorganized company. Merrill-Stevens' reclassification was thus not a demotion but in fact a "privilege" (III 91).[27]

Paralleling this compromise with Merrill-Stevens, the trustee made an equally inexcusable deal with Shaffer-Spitzer. The charges against Shaffer-Spitzer had been proven by the trustee himself: its claim, he had found, was grounded in fraud, was subject to defenses and counterclaims, the unmasked wreckers behind the mortgage were to be subjected to suits to account for their profits,[28] and the mortgage itself subordinated to all other interests including stockholders. (I 282 ff; II 1096). It was and is indisputable law that a creditor claim by a faithless insider must be subordinated to the claims of all other creditors and of stockholders too. *Taylor v. Standard Gas etc. Co.*, 306 U.S. 307.

Yet with no record of so much as a suggestion why that law did not obviously apply to these facts, the "compromise" scaled the Shaffer-Spitzer claim down by only the amount of the initial – and unconscionable, whether or not technically usurious – discount between the $330,000 face amount of their mortgage and the $280,500 cash they had paid the company for it (and for 10,000 shares of bonus stock then selling at $1.25 per share. I 275,286) and even the loss of dis-

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[27] Supra p. 12 n. 8. We discuss below p. 62 the conflict of interest that arose from the fact that not alone Merrill-Stevens but everyone else represented on the new board was beholden to the trustee, and he was beholden to them for the presidency.

[28] Shaffer's net profits alone amounted to over $240,000 (I 281).

count was more than made up by allowance of "back interest" from 1958 accruing at $16,000 per year, an allowance that was given to no other party to the reorganization, not even to creditors with undisputed maritime liens (I 275,286; II 289,384). Setoffs and counterclaims earlier asserted by the trustee were put aside; while a suit was started against Abrams and others for procuring the false appraisal of the Wilmington property, other suits on the stock frauds affirmatively recommended by the trustee himself (I 289,291,294) to be brought against, e.g., Abrams, Shaffer and Erdman, were not.[30] Not until Plan III proceedings three years later in 1965 (with statutes of limitation running all the while) did trustee's counsel for the first time admit that utter abandonment of these suits, (although it never appeared on the record), had been part of the Shaffer-Spitzer mortgage compromise then "settled in the plan of reorganization" (III 192). Not a word of this appears in either Plan II or III, or in the proceedings on Plan II. Both plans expressly reserved all causes of action other than those stated to be settled (II 709, III 259, 273). When creditors' counsel inquired on the point, he was fobbed off (II 935-6).

In addition to this patent lack of substantive merit in the two compromises, and the lack of timely disclosure that the Shaffer-Spitzer compromise included a sweetener by way of abandoning TMT's rights against the Shaffer-Spitzer principals, they involved still another defect: there was no record disclosure of the basis for either compromise. When the trustee was given an opportunity to state the basis of the Shaffer-Spitzer deal, he testified only that it resulted from

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[30]Cf. judgment for $406,250 obtained by Chapter X trustee of another Abrams-wrecked corporation, *Kirtley v. Bankers Life etc.* 198 F Supp 30 (S.D.Iowa) reversed as to exemplary damages only, 307 F2d 418 (CA8). Other substantial benefits for the estate have resulted from investigations: reduction of debt from $5,200,000 to about $3,150,000 and subordination of insiders claims, *In the Matter of Texas Portland Cement Co.*, 205 F Supp 159 (E.D.Texas).

a conference in chambers.[31] Thus he supplied not the imperative why but only the collateral who and where. As to the Merrill-Stevens deal the trustee's answer was to quote, from a SEC letter not otherwise in the record, a short mention of proof difficulties as to some of the SEC objections and a statement that some compromise might be in order.[32]

But this is far from either a recommendation by the SEC of the terms of this particular compromise or a disclosure of the reasons why the trustee adopted those terms. Moreover his answer dealt only with the SEC's own objections. It did not touch at all the committee's independent, separately documented, further-reaching and later-filed attack on the Merrill-Stevens claim. This the trustee never attempted to answer.

[31] "Q: Regarding the alleged compromises of the Shaffer-Spitzer mortgage claim, and the Merrill-Stevens claims, as provided for in the Creditors' Plan, could you give us some indication as to the basis of those compromises?

A: I will be glad to. I will be glad to.

* * *

Q: Would you answer the portion of my question directed to the compromise of the Caplan mortgage claim?

A: The compromise of the Caplan claim was worked out between the attorney for that group, my attorney and myself. It was done in a conference the three of us had with the Court. It was completed after considerable deliberations and negotiations. It was submitted to the Court and approved by the Court and that is the way we came about to reach that conclusion." (II 283-4)

[32] "I have been summarizing their [SEC] objections to the Merrill-Stevens claim. I quote:

'We will be noted here, some of the objections are based on technical engineering facts which would require expert testimony as proof. Other objections are based on circumstances which occurred in 1956 and 1957 and their proof would require the testimony of individuals who witnessed the events.

'We believe, therefore, that to the extent possible, it would be helpful to reach an agreement with Merrill-Stevens.'" (II 284)

The trustee's and the district court's erroneous assumption that the trustee had no obligation to disclose what underlay his recommendations is illustrated by the trustee's earlier proposal for allowance of the Merrill-Stevens claim in full amount. We have quoted that document, astonishing because purely conclusory, at p. 25 n. 23. But § 167 requires that the trustee "shall report to the judge any *facts* (our emphasis) ascertained by him pertaining to frauds, misconduct, mismanagement and irregularities, and to any causes of action available to the estate." Facts, not opinions.

No facts about these compromises, other than those just reviewed, appear in the record. The district court's approval order indeed copies almost verbatim the trustee's nebulosities of ex parte opinion (II 373).

Thus both the trustee's recommendation and the district court's acceptance of the Merrill-Stevens compromise, discounting to zero some 35 pages of detailed and unanswered committee Specifications of holes in the Merrill-Stevens claim,[32] rested ultimately on the fact that two unnamed backroom-boys in the office of trustee's counsel had made an unrecorded examination of unspecified evidence presented long before the committee's tender of its Specifications; and the trustee reported and the district court accepted their unamplified opinion that litigation with Merrill-Stevens was unlikely to result in any material reduction in the claim.

If binding force is to be given an alleged compromise, there are standards of open disclosure that must be met. They are spelled out in General Order 33, applicable to reorganization by General Order 52(2). The requirement is that the appli-

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[32] In granting permission to make this investigation, the court had remarked:

> "I am concerned myself. I do know that whoever turned that vessel loose with the boilers in it, somebody made a bad mistake. I don't know who it was. * * * Everybody knows about the Merrill-Stevens' claim and the bulk of it is that those repairs were not properly made and resulted in a boiler breakdown, which caused all the main trouble, at least." (II 36-7).

cation for compromise approval shall "clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interest of the estate that the controversy be so settled." Interested parties must be advised of the facts fully enough to act intelligently, and it is the trustee's duty to see that they are. *Matter of Natl. Public Service Corp.*, 68 F.2d 859 (CA 2), cert. den. 292 U.S. 641.

In re Associated Gas & Elec., 61 FSupp 11,15,18 ff., aff'd 149 F.2d 996 (CA2) is the exemplar for successful compromise in reorganization. There the compromise was developed in open negotiations with SEC counsel present,[33] was referred to a special master, who conducted hearings and submitted a report which was itself the subject of court hearings.

Indeed we do not think there exists any reported case sustaining district court approval of "compromise" on such flimsy counterfeit of trustee's report as here. The uniform test of the reorganization compromise cases is that the record must show on its face enough information as to the controversy to be settled, the strengths and weaknesses of the opposing contentions both legal and factual, that court and parties can make firsthand "informed and independent judgment", in the phrase these cases quote from *Nat'l Surety Co. v. Coriell*, 289 US 426. The compromises in the present case may be measured against the extensive detail that was found in *Ashbach v. Kirtley*, 289 F2d 159 (CA8), a case involving the same Abrams who lurked here behind the Shaffer-Spitzer claim, to be "not sufficient information" to make such a judgment; or the even fuller detail that was found in *Conway v. Silesian-Amer. Co.*, 181 F2d 201 (CA 2)

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[33] By contrast in this case, a creditor-stockholder negotiation in the presence of SEC staff drew a district court reprimand to the SEC (III 378-9) for attending the negotiation at all, and the court's gratuitous and erroneous (cf. affidavit III 399) suggestion that the thrust of the negotiation was to buy off counsel for the committee without paying off the stockholders.

to leave "too many questions unanswered", resulting in "a lack of sufficient proof of the adequacy of the settlement proposed to justify acceptance of the plan as fulfilling the statutory standard." (at 201). Surely this trustee's few lines of off-the-cuff opinion of troublesome litigation in prospect, quoted footnote 23 above, do not meet the test of these cases.

Perhaps the most explicit guide to the requirements for reorganization compromise that the trustee here failed to meet, is *In re Chicago Rapid Transit*, 196 F.2d 484 (CA7), where a trustee proposed to compromise a creditor's claim and the company's counterclaim by roughly splitting the difference, and the district court approved. The court of appeals stated the question of the case to be "whether a reorganization compromise" . . . solely on the basis of expediency and the desire to forestall further lengthy and expensive litigation, with no attempt at considering the relative merits of the conflicting claims of the parties" (at 485) is thereby invalidated. Reversing, the court of appeals commented that the trustee "should be required to state his reasons for his lack of confidence in the analysis of his own accountant" (at 491), comparable squarely here to the trustee's lack of confidence in his own on-the-record analysis of the Shaffer-Spitzer claim:

> "The * * * Court * * * was in duty bound to ascertain the merits of [the creditor's] claims as well as the probability and merit of the trustee's claims against [the creditor] * * * We think there can and should be a reexamination – or rather an examination of *the legal and accounting theories* which give rise to the conflict in claims, *without necessarily going into the actual evidence* on the accounting. Such an examination of the underlying reasons for the conflict should furnish some basis for consideration of the fairness of the proposed settlement and whether or not it would be in the best interests of the debtor estate * * *", (ibid, our emphasis).

Passing for the moment both the lopsidedness of both compromises and the fact that from the Merrill-Stevens compromise springs joint control of the reorganized company in Merrill-Stevens and the trustee himself,[34] what is obvious from this case law is that the trustee has failed in his duty of disclosing the legal and factual basis for reversal of his earlier position of objection to both claims. Short of demonstration of the death of key witnesses or the disappearance of key papers or the overruling of key case law previously relied on it is difficult to see any excuse for his panic flight. He has simply not provided the information to meet the compromise requirement that he supply all the raw material necessary for the court and the parties to exercise firsthand that "informed and independent judgment" that *Coriell*, supra, 289 U.S. 426, 436 requires.

The trustee's failure to present the facts of his deals with Shaffer-Spitzer and Merrill-Stevens in the fashion which might have lent to them the guarantees of openness whether by separate compromise under GO 33 or in connection with a plan, is only another aspect of the multiform error injected into this case by the failure to discharge the duty of investigation and disclosure under § 167. Cf. *Consolidated Rock Co. v. DuBois*, 312 U.S. 510, 523 (1941), where the nuisance and delaying effect of litigation to determine the validity of the debtor's claim against an insider was urged, as in the case of the mutual claims involved in *Chicago Rapid Transit*, supra. p. 34, as ground for stomaching as compromise the treatment accorded that insider. This court rejected the attempt to justify the unjustifiable:

> "The fact that the claim might be settled, with the approval of the Court after full disclosure and notice to interested parties, does not justify the concealed compromise effected here through the simple expedient of extinguishing the claim".

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[34] This feature of the reorganization (Question 4) is argued below, p. 61 ff., p. 35 n. 34.

Moreover, it should be adequate answer to any claim that an insider's bargain embodied in a reorganization plan is thereby sacrosanct as compromise, to note that the *Deep Rock* case, a foundation of the last 25 years of reorganization plan law, itself set aside a compromise plan. *Taylor v. Standard Gas and Electric Co.*, 306 U.S. 307, 312, 323.

C. Investigation, required by Chapter X, of affiliations of new management, of payments made or promised, and whether the proposal of the plan and its acceptance are in good faith and not procured by means or promises forbidden by the Act, was ignored.

Mandatory also is investigation of the affiliations of new management (Sec. 221(5). These must be fully disclosed, the appointments must be "equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

> "Courts have been too prone in the past to take into consideration claims on the assets and claims on the earnings but not the allocation or disposition of control." Commissioner Douglas, *Hearings before H.R. Committee on the Judiciary*" on HR 8046, 75th Congress, 1st Sess. (June 1037) p. 169.

The statute requires that the judge be "satisfied" that such matters have been fully disclosed. The statute does not mean satisfied as with a placebo.

This history of Plan I should have itself demonstrated that it was, in the statutory words, "against public policy" to allow Merrill-Stevens representation on the board, without refutation of the charges that they had participated in prereorganization wrecking of the company and prereorganization stockpushing fraud. It does not take elaborate legislative history or case law to find in the term "public policy" the conception that people responsibly accused of fraud do not belong on the board of a publicly held company: the Plan I experience with Shaffer-Spitzer, dominating the Plan I board in the face of uninvestigated fraud charges, is itself the aptest precedent.

In still another direction the Plan I experience afforded a warning disregarded. Merrill-Stevens had then demonstrated itself not above participating in plan dealings not "in good faith" and by "means or promises forbidden by this Act." This had occurred when Shaffer-Spitzer bought Merrill-Stevens' consent to Plan I by agreeing that after consummation it would take off Merrill-Stevens' hands for $100,000 cash (a $50,000 bonus price) a block of new preferred stock that Merrill-Stevens was to receive under that plan for some of its claims, an offer that was made to no other creditor and that turned Merrill-Stevens' blocking opposition of Plan I into acceptance (I 39-41,198-200,236). It cannot be said with certainty that the trustee's abandonment of his threatened investigation of the Merrill-Stevens claims, ("accepted and settled out of court," he reported: II 23-4), just one day after the bargain with Shaffer-Spitzer was struck, (I 200-203) was contribution to the deal. But the episode at least should have alerted even a very naive trustee to be suspicious of the good faith of plan votes by major creditors with inside connections.

Two such votes on the new plans clearly were not above suspicion.

In the second and third plans, decisive votes were cast by the Florida Towing-Coppedge group and by Salley, trustee (II 878,879,902; III 316 ff; cf II 755). Salley was trustee for Langston and others, unidentified at the time of the second plan (II 917,938), but at the time of the third plan Langston was disclosed to be the trustee's insurance broker. (III 353-4). Langston and Coppedge became members of the new board (II 987, III 353-4). Florida Towing had originally had a small lien claim. Salley or Langston apparently none at all (II 558, III 317,322). By the time of the third plan they had acquired or controlled claims that gave them the statutory controlling voice in two classes of priority creditors: 70% of class 6 (III 317; cf II 682,755,795,902); 100% of class 7 III 318), and a substantial and important voice in the unsecured class (III 320,322,323).

During the reorganization the trustee had made Florida Towing the beneficiary of the largest single contract in the TMT operation, to move the barges between Florida and Puerto Rico, amounting to about $1,500,000/year, latest figures in the record, at a price that was more than $100,000 per year in excess of a competitive bid.[35] Florida Towing, at the time of Plan II, had offered TMT a $100,000 loan, critical to feasibility (II 313-14,319-22,833,835,837-38), expressly conditioned on the retention of the trustee in management (II 319-22, 837; fudged 750).

Nearly all these insiders' claims had been bought during reorganization at heavy discount ((II 867,911,932, III 317 ff.).

The discount claim purchases by these members of the new control group, beneficiaries of the trustee's patronage during reoganization (and so presumably after the reorganization), were clearly within the scope of § 203, which provides:

> "If the acceptance or failure to accept a plan by the holder of any claim or stock is not in good faith, in the light of or irrespective of the time of acquisition thereof, the judge may, after hearing upon notice, direct that such claim or stock be disqualified for the purpose of determining the requisite majority for the acceptance of a plan."

Its purpose, as disclosed in the legislative history, is to frustrate the person who buys up claims at default prices in order to sit in a strategic position to exact "some particular preferential treatment, such as the management of the company", or, as here, a key share in management plus lucrative reorganization patronage. SEC Commissioner Douglas, *House Hearings on HR 6439, 75th Cong., 1st Sess.* (1937) quoted in *Collier on Bankruptcy*, ¶ 9.21"

"When a purchase is in aid of an interest other than as a creditor or stockholder, such purpose may amount to *bad*

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[35]The effect of this contract on valuation is treated infra p. 48.

faith." Matter of P-R Holding Corp., 147 F.2d 895,897 (CA 2, our emphasis). Nevertheless, although the point was raised both specifically in terms of claim-buying under § 203 and generally under § 221 (4,5) in terms of the need for investigation of affiliations of Coppedge and Langston (II 261; III 245-6), no investigation took place; the district court declined (III 264) although asked (III 245-6), to investigate. Nor was there any compliance with the committee's reminder that the remarkable bank loan discussed infra p. 54 also needed looking into.

Investigation is called for when the judge knows that persons close to the trustee and who will serve on the new board and will vote on his election to the presidency and his salary and stock options, (a) have bought claims at a discount during the reorganization, (b) hold lucrative and substantial contracts from the trustee, and (c) have offered the trustee loans which were essential to the feasibility of the plan and were conditioned on the trustee's retention in management. These things, the district court suggested, do not amount to proof of wrongdoing (III 264). They do amount to proof that, assuming wrongdoing was absent, a court whose trustee had erred as badly as this one had in Plan I was required by § 221 to be alert to enforcing the fullest disclosure, when the trustee's personal ambitions were implicated.

D. Essential valuation facts were withheld by the trustee.

Valuation facts have not only been withheld from the record, they have been withheld from the parties and others entitled to them. Creditors and outside bidders as well as the committee and responsible interests brought in by the committee were frustrated in the development of reorganization plans and in establishing the true value of the enterprise by the withholding of essential information. II 71-2,240,244,

245,246,248,310.49-.51,929,930,951,954) Towing bidders were similarly diddled[36].

Information the trustee had prepared was refused in a way that not only defeated serious study but advertised that outside investors were not welcome. One instance of this is disclosed in the record in detail. If the estate is to be properly valued, or if fresh money is to be raised for possible rehabilitation of the enterprise, it is not enough to know the gross revenues or net earnings, even the true net earnings. A serious business inquiry calls for much more detail: the actual utilization of existing capacity, the point at which capacity would be fully utilized so as to make appropriate additional capital investment, the sales mix (Cf. *Villers, Dynamic Management in Industry*, 1960, ch. 14):

Although information as to the extent of utilization of TMT's capacity was already a matter of public record (II 80-1,96,97,178-9,230-9), the trustee refused to supply it to the committee or to a knowledgeable responsible investor who had tentatively valued the company at more than the trustee then said it was worth (II 96-7). Both before and at the valuation hearing, the trustee denied that this information existed in any form (II 94-5), then claimed it was a trade secret (II 95-6), then claimed the committee already had the information and should not want to know so much (II 97). The information sought was vital because the trustee claimed (and the district court accepted the assertion, precluded cross-examination on the subject, and based his valuation analysis on the contention) that the ships were already carrying their maximum (II 224-5; 70-2, 387.3-.5). In fact, there was substantial free space and free tonnage to carry

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[36] When the committee produced prospective towing bidders, majors in the industry (II 951,954), the trustee violated the district court's instruction to supply copies of the draft contract to bid against (II 929,954) and the general manager inadvertently disclosed that the negotiating atmosphere was so bad that one of these bidders broke off negotiations and would only deal direct with the court: this firm was still willing to bid, but it would not deal any further with this trustee (II 945).

more freight at less cost (II 179,230-9; cf. 1078-9). An investor who is refused the detail of this information knows he is unwelcome.

This illustrates the refusal to disclose. Active concealment took place when the trustee insisted on valuing the enterprise as a 3-ship business, refusing to discuss as too speculative the consequences of 4-ship operation (II 107-8; cf. 77,82,225,310.36-.38, 1079-82,1083), but failed to disclose that for some time before the hearing he had been actively in the market for a fourth ship which he actually bought before the conclusion of the approval and valuation hearings (II 310.1,310.13,310.44,357,865,876).

Refusal to investigate (or if he investigated, failure to report, we cannot know which) is exemplified by the lack of response to the committee's assertion based on specific investigation of the market that ships we said were needed were available in the market at prices the estate could afford and could finance (II 1079-1082). The trustee made, so far as the record shows, no investigation of these specific leads and did not divulge calculations he had in fact made as to projected earnings realizable from new ships and new kinds of ships (II 82,107-8,310.34, II 61-3, 144-148,150). Similarly, calculations of the portion of overhead allocated to the reorganization were made but not furnished (infra p. 49), and interim earnings figures needed to cross-examine on whether an upward trend was ending (it was not, II356) were refused II63-4)

This perseverated pattern of failure to make and refusal to direct required investigations and disclosures fatally impairs the plan on appeal.

These violations, we say, are not several. Woven together, they make up the fabric of this reorganization proceeding. The lack of investigation in this proceeding is not minimal error. The failure to investigate may deprive stockholders of greatly increased assets or saddle the stockholders with exaggerated claims against the estate – may even cause an appearance of insolvency and hence elimination of stock-

holders from participation. When the charges that are denied investigation are of misconduct and fraud, and because uninvestigated, control is or may be thereby given over to the hands of wrongdoers, the injury to stockholders is great and the perversion of the policy of Chapter X is clear. When suppression of investigation appears linked to the trustee's position in the reorganized company, the injury to the public is even greater for it is deprived of the protection of a system of impartial administration.

When full disclosure is not made of compromises, the power of intelligent decision is lost; when abandonment of suits and substantial counterclaims is an undisclosed term of the compromise, the injury may be crucial to the financial health of the estate.

Investigation and disclosure are tools for the protection of the public – whether it be of causes of action or affiliations of officers. Failure of this statutory duty, especially where responsible charges are made, even more especially where fraud is charged, becomes crucial when connected with control by insiders on the one hand and when used as a tool by a self-serving trustee on the other hand.

POINT II: Stockholders were excluded from participation in the reorganized company by an insolvency finding based on a valuation at odds with controlling standards set by this Court.

The question of valuation must be discussed primarily on the basis of the 1962 plan proceedings because, as we shall show, the district court erroneously failed to look afresh at this matter in 1965, taking the position that the correctness of its views had been, although the court of appeals later held otherwise, sustained in the appeals from the 1962 plan.

The district court held in 1962 that the company would not "necessarily" benefit from the growth of its market (II 387.4). The crux of the valuation error is precisely this misstatement of the issue. The issue is not whether the company would "necessarily" do so, for "a prediction as to what will occur in the future, an estimate, as distinguished from

dated Rock Prod. Co. v. DuBois, 312 U.S. 525, 526. On the issue of solvency arising in connection with reorganization plans "the commercial value of property consists in the *expectation* of income from it." *Galveston, H & S.A.R. Co. v. Texas*, 210 US 217, 226; *Consolidated Rock Products Co.*, at 526. "The basic question in a valuation for reorganization purposes is how much the enterprise *in all probability* can earn * * * It entails a *prediction* of future events." *Institutional Investors v. Chicago, M. St. P. & P.*, 318 US 523, 540, 542 (1942). Mathematical certainty is not called for, but an *"estimate."* But that estimate must be based on an informed judgment which "embraces all facts relevant to *future* earning capacity and *hence* to present worth" including, of course, the nature and condition of the properties, the past earnings record, and *all circumstances which indicate whether or not that record is a reliable criterion of future performance" Consolidated Rock Prod. Co.*, at 526 (our emph.).

A. The district court's valuation erred in neglecting all evidence of continuance of current trend of increasing traffic and increasing gross earnings.

The trustee expressly contended (II 58; Ex V-7, II 224-226; 51, 63, 64) and the court acted on the assumption that revenue had reached maximum in 1962 (II 387.4) and would not go above $3,124,000 (II 224). In fact the assumption was unwarranted. Revenue has continued to grow steadily, even without effort by the trustee (II 1090), from $1,640,000 in 1958 (II 199) to $3,802,000 in 1962 to $4,779,000 in 1964, latest year in the record (III 274). This growth becomes more meaningful against its background—expansion of the Puerto Rican economy to which the prosperity of the company is directly related, and the shift of that economy to increasing export-import trade (II 242). The company's growth has been confirmed by capture of a steadily growing proportion of a steadily growing market (II 246).

The foundation for the trustee's 1962 valuation was the explicit assumption of "continuing to use the three vessels" on the then "present frequency of sailings" (II 224-5, 657).

This assumption had been already contradicted by the trustee's own words and acts[37] yet it was the premise of the entire approach to the valuation that the current operation was the only reliable factor of future performance.[38] By

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[37] April 1961 - ". . . demands are continually increasing and volume steadily increasing without any special emphasis by the trustee in efforts to develop new business" (II 1090)

August 1961 - Additional vessels of improved design should be acquired in order to handle the increasing traffic and insure continuous service (II 5)

February 1962 - If the present volume of business continues to increase a fourth trailership is needed (II 657)

May 1962 - The trustee has been offered . . . more traffic . . . from Florida to Puerto Rico than the existing three vessels can handle and there is a backlog of merchandise . . . for movement to Puerto Rico" (II 310.1, Petition for Purchase of Vessel)

[38] Q: But if this enterprise were out from under the proceedings, would it? [i.e. would it be appropriate to ascertain the cost of efforts to increase the volume carried southbound in the off peak season, the possible increased revenue from such efforts and the possible increased profits?]

The Court: Well, we are dealing with an organization that is in. Let's assume that it will stay right there and try to get the value. It is not going to get out until it is reorganized.

Mr. Mason: "We are trying to get the value when reorganized".

The Court: "That is of no importance to me. Let's value it as it now exists to determine what should be done in these proceedings." (II 170)

Q: . . . That you would take the historical earning records, that you would examine or determine whether there are reasonably foreseeable factors that might tend to indicate an improvement in earnings or a diminution of expense?

The Court: All these projections into the future are not going to bother the Court. These creditors have waited too long to get their money". (II 192)

Valuation Order: "The only reliable factors are what the debtor is doing now" (II 387.7)

The Court: "There is no future prospects other than what is going on". (III 55-56)

refusing to consider "all circumstances" which indicate whether the past earnings record is "a reliable criterion of future performance," the court put future performance into a strait jacket. Notwithstanding an additional vessel was purchased in June 1962 (II 357) (before the valuation order which found the debtor insolvent), the trustee declined (II 107-8; cf. 1029) to estimate the expected additional income. The court discounted the effect on earnings from this fourth ship because the amount was uncertain and because its purpose was now said to be replacement for anticipated breakdown of the old barges (II 387.7). In fact, the fourth ship was not a replacement but was needed and used as an addition to the fleet (II 865).

The trustee should have put into the record estimates of additional income from such foreseeable and foreseen increases in equipment (see infra p. 53). This was admittedly possible,[39] nevertheless he failed to do so.

B. The district court's valuation erred in rejecting evidence from cash bids higher than the trustee's and his own valuation estimates.

If there were a well-advertised open opportunity to bid under fair conditions for the debtor's entire business and assets, the bids would surely have to be given substantial weight as evidence of minimum worth of the company. But bids were not invited (II 97-8; III 53); and uninvited bidders presented by the committee (II 96; cf. I 189,190,466) were given ample hints that they were regarded as poachers on private domain by being refused elementary and necessary information about the company (supra p. 39). Every plan that received the trustee's approval was a plan that had a job for him. The cash plans did not, and he openly announced his preference for an internal plan over no matter what cash plan (III 660).

[39] Would you be able to make a projection of changes in revenue, expenses and profits under an assumption that there were additional vessels available to the debtor? . . . Could you do it on the basis of the present information in the records of the debtor? "Yes" (II 82; cf III 61-63,150)

In spite of discouragement, U.S. Freight and a Pottharst group, both well-informed and financially responsible (II 159-62,644-7) volunteered bids on their own initiative for the company on an all cash basis. It is readily understandable that their bids were geared to current indications of the court's thinking and proceeded by small increments just topping the trustee's or court's or rival bids each time. Nevertheless the bidding rose briskly from $1,700,000 in April to $2,800,000 in December 1962 while the valuation and Plan II were under consideration[40].

At the confirmation hearing, February 4, 1963, when the cash bids had reached the level of $2,800,000 (II 865), both cash bidders made clear that this was not their top figure (II 880,911,938,939). But the trustee ran them off a week later, by showing them a draft order, later signed by the district court, rejecting the $2,800,000 as "not worthy of consideration" because major creditors would block it – although it was already higher than the court's own valuation (II 880,881)[41]

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[40] Trustee's expert: $1,607,692 (II 125) — cash bidders $1,700,000; 1,800,000; 1,850,000 (II 665,666,668)

Trustee: $2,031,403.72 (II 229) — cash bidders $2,100,000; 2,150,000; 2,200,000; 2,250,000; 2,515,000 (II 681,685,246.2,-.5,-.6,750)

Court: $2,700,000; 2,780,000 (II 312,387.5,885) — cash bidders $2,700,000; 2,800,000 (II 819,865)

[41] The order itself discloses: ". . . major creditors indicate clearly that any such proposal to sell the assets of the debtor to outside interests will not be acceptable." (II 884-5). The trustee had made clear in advance his preference for an internal plan over any cash plan (II 660) and Florida Towing, the controlling creditor in class VI, had announced in open court its intent to block any such plan (II 779).

All the blocking creditors were insiders – Shaffer-Spitzer and Merrill-Stevens votes subject to rejection on grounds of fraud, supra p. 24ff, the Coppedge and Salley (Langston) groups to cutback under § 203 for discount claim-buying in aid of patronage, supra p. 38.

Just because outsiders' bids rhythmically topped the trustee's and court's valuation, it put the court on notice that its own valuation, as well as that of the trustee's expert and the trustee, was, by the test of the market, unrealistically low and required serious reexamination; particularly in view of the valuation of upwards of $4,500,000 already presented by the committee's expert witness, based on this Court's analysis (II, 180, 240-248). All those interested in the estate are entitled to the court's protection, and an alert court would have re-examined both the indicated higher value and the allowance of the contested claims for their effect on the narrow gap between solvency and insolvency. And it should have been a spur to the trustee to encourage the highest possible bid for the benefit of the trust.

C. The district court's valuation was erroneously based on net earnings after wilfully padded current costs.

The court of appeals regarded it as a confirmation of the wisdom of the district court's 1962 refusal to recognize already visible trends of the company's postreorganization future, that the net profits reported by the trustee for 1964 dropped after a rise, 364 F2d at 940-1. This drop in net profits, however, results from some costs plainly juggled. The record shows that notwithstanding an unanticipated rate war (III 127) revenues continued after the 1962 hearing to grow just as the Committee's expert witness had predicted they would (II 249; III 231-2), but that cost increases cut down the net profit. These cost figures, however, are fictions.

In part they rest on a bookkeeping manipulation of reserves beginning in 1962, the year of Plan II, that padded the costs by an average of more than $50,000 per year. In part they reflect milking the profits in favor of Florida Towing, beginning in 1963, by $1000 per voyage or over $100,000

per year, (supra p. 38) the more voyages the more milking as traffic grew, (infra p. 53). In part they consist of refusal to disentangle true operating overhead costs from heavy non-recurring reorganization costs, in an amount that we charged without rebuttal was in the range of $140,000 back in 1961 and can hardly have suffered any material decrease in the audited years 1962-4: refusal to disclose these essential figures is a phase of the trustee's general policy of withholding essential valuation facts, supra p. 39. Detailing all these cost elements in turn –

Reserves: – Beginning in 1962, the year of valuation, the trustee set up new reserves now totalling over $160,000 for the last three years for which audited figures are in the record, 1962-4, or an average of over $50,000 per year. Since they had not been spread back over the long term they constitute a sudden downward jar to reported net income, that does not reflect any increase in operating costs, as the trustee's general manager admitted (II 921-3). The trustee's own CPA was compelled to refuse a clean certificate and has continued to flag them in each report in the record: adding back the new 1962 reserves to 1962 reported profit corrects the reported net earnings for that year to $655,000 (II 891.1; III 283).

Tugboat Contract – Now that TMT's self-propelled trailerships have been foreclosed away, and all sea transportation is by towed LST barges, tugboat hire is the heaviest operating cost, $870,000 in the 1961 figures for Plan II, $1,475,000 in the 1964 figures for Plan III (over 30% of revenue, II 217; III 280). Florida Towing Company, a Coppedge family concern, had done some of this work for the old company and was a minor maritime lien claimant. As discussed elsewhere (infra p. 63), it started as an outsider whose reorganization plan was rejected at the time of Plan I, but it tendered the company a $100,000 loan needed for Plan II, and in both Plan II and Plan III it became an insider with a Coppedge on the new board. In 1963, just after approval of Plan II, its towing contract came up for renewal, and was relet with only a pretense of competition. Florida Towing was given

the contract at an increased rate of $1000 per voyage, although a rival bidder offered to do the work at the old rate.[42]

The lower bid was rejected by trustee and court on the asserted ground that the bidder was himself a potential reorganizer, and that the bidder had no tugs of his own and was therefore "nothing but a broker" (II 946-9, 952-3; III 934-5). One would have thought Florida Towing no better qualified if disinterestedness be the test, since it was itself a power in the reorganization; and surely an underbid by a broker should have put the trustee on notice that aggressive shopping could turn up a principal at a rate cheaper still. In 1965 the Florida Towing contract was renewed at the same rate, this time without even pretense of seeking competitive bids, again over our protest (III 70, 90, 98). In so loading expense by a minimum $1000 per voyage patronage to this insider, the annual added cost to the company, at over 100 voyages per year (III 97), is upwards of $100,000.

Overhead: – In 1961, the year whose figures based Plan II, the composite overhead figure was $283,000 (II 217, 1077); and well before the Plan II hearings we had warned the trustee of his responsibility to break it down (II 1077). By 1964 the figure was apparently up to some $443,000, (III 280: inconsistent rubrics make it not too easy to match figures). In the Plan II hearings the trustee's general manager said he had made this breakdown, but he did not accede to our request to produce it at the hearings (II 73-6). In the Plan III hearings the general manager denied he ever had any such figures at all (III 182-3). No matter which of these two phases of his testimony is the truth, the fact remains that until reorganization costs are dissected out and discarded as we have demanded, the overhead cost figures used by the trustee are improper basis for earnings calculation and therefore for valuation. Taking the committee's unrebutted estimate (II

[42] For the trustee's violation of instruction of the court that he supply to still other responsible bidders a copy of the draft contract to bid against, and the trustee's repellent treatment that ran those bidders off, supra p. 40 n. 36.

1078) of one half, in default of the better figure it was the trustee's clear duty to supply, this is $220,000 of cost padding.

To collect the above three items of cost padding, they are the new reserves at $50,000 per year, the buried reorganization costs at $220,000, and the $100,000 fat in the tug work, a total of over $370,000. Capitalized at the district court's 10X/2 rate (II 387.5)[43] the valuation figures go up by $1,850,000, three times the insolvency gap once the fraud-tainted claims are barred.

D. The district court erred in considering future earnings as based on current high costs in disregard of the trustee's existing calculations of programmed post-reorganization modernization economies.

A further factor in the upward distortion of reported costs and downward distortion of reported net profits is per-voyage cost increases attributable to the reorganization itself. These arise solely from the fact that the reorganiza- has been so protracted that the trustee by choice (I 210, III 30, 62, 143, 145) has not yet put into operation the cost saving measures he has long plannned. On loss of the old company's self-propelled vessels through foreclosure, the trustee continued operation with concededly obsolete and expensive LSTs (I 473, III 62,154). He had to increase his fleet of them to 5, from the 3 with which he was making his 1962 profits (II 225; III 152), in order to serve the constantly increasing traffic tendered him, for under reorganization conditions he could not (or said he could not) finance more modern vessels we had urged him to buy (II 1079-82)

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[43] The court divided by 2 to allow for taxes and multiplied by 10 as a capitalization factor. This conservative capitalization has no record support whatever, since the only record information of the rate at which the market values earnings in comparable industries shows a 13.8 rate (committee's expert, II 246-250); 11.2 rate (trustee's expert rebuttal II 303-4); "somewhat higher than they were two and a half years ago" (SEC offer of proof III 200).

and which he had already programmed in detail to replace the LSTs—but only after reorganization (III 126,138,139, 153-4).

The older these vessels, the more they cost to keep running. The general manager admitted that for the year 1964, whose figures were used by the district court to support his view that rising costs made the company "more insolvent than before", the excess maintenance cost on the two oldest vessels alone was some $150,000:

> "[T]he year '64 required total costs of $249,000 [rect. $259,000—chart, III 78] in shipyards on those two vessels. * * * The normal costs for those vessels, if they were not that old, in that condition, would be between $50,000 and $75,000 to recertificate; leaving an excess cost of $146,000 per year which is chargeable to the fact that the company was not reorganized sooner and those vessels replaced by the new owners, which, no doubt, they would." (III, 30-1)

Thus it is the continuance of the reorganization that has itself aggravated the inefficient high cost operation conditions of the reorganization period, and has prevented achievement of the efficient postreorganization operating conditions with replacement vessels. The trustee has existing plans and figures for these vessels and for their financing and the operating results of their use, which he has projected with business-like detail but kept out of the valuation record:

> "* * * from our studies that we have made, from which we have not made formal plans, we can carry the increased capacity in four vessels that are stern loaders that five vessels as they are now loaded will hold, so we have twenty-five percent increased cargo capacity in a specially designed vessel and improved type of sea-going tug. With these we can come out with costs in which it would be economically feasible to spend two million dollars for each of those vessels." (III 61)

"Q. Mr. Thouvenelle [general manager], when did the trustee or you first begin to make these projections on the basis of this new type of vessel?

"A. When we first started to have trouble with the old ones four or five years ago. * * *

"Q. When did you come to these cost conclusions you have just given us?

"A. Oh, at various times. We have not advanced any formal plans. But we have put enough figures together to know that our conclusions were sound." (III 62; see also II 82, 86)

The new vessels, if the company had had them, "would, by this time, have restored the competitive advantage even though the rates are lower than they were in 1962." (III 139)

To compute 1965 going-concern value on the basis of such high-cost reorganization-period operations in the face of such firm plans for post-reorganization cost savings is an even more stubborn rejection of this Court's case law, supra pp. 42-43, than was the district court's 1962 rejection of the clear trend of traffic increase.

E. The district court erred in not reexamining in 1965 the valuation erroneously made in 1962.

All the defects of the Plan II valuation were compounded in Plan III. Although the court of appeals had not passed on our attacks on the standards applied by the district court, on the erroneous limiting of the scope of inquiry, exclusion of material testimony, allowance of improper compromises in the computation and failure to give weight to cash bids (II 392-94), the district court erroneously concluded that the appellate court had affirmed on those matters. Therefore the district court limited the record, on remand, to events since the altogether inadequate and unsound 1962 valuation (III 66,235,243,266-8). The court reached the trustee's requested finding on this again inadequate hearing, that the estate was "more insolvent" than in 1962 (III 13,266). The court reached this view even though revenues

had grown as the Committee had predicted in the teeth of the trustee's 1962 evidence and the court's express 1962 finding that revenue had reached its maximum (II 387.3):

> [Cross examination of the trustee's general manager by SEC counsel]
>
> "Q Mr. Thouvenelle, notwithstanding the two appeals, one taken by the Stockholders' Committee and the other taken by the Government, and rate cuts and hurricanes and competition, you still managed to increase your volume of business handled, year after year after year?
>
> "A Yes (III, 34).

The court persisted in this view even though substantial new revenue-producing equipment had been acquired out of these earnings as the Committee had predicted it should and would (II 243-4,1081) and even though important operational improvements had been made or were in a concrete stage of preparation.[44] The court also failed to consider the

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[44] That the growth was fairly predictable is reflected in these figures for revenue:

	Trustee's 1962 prediction (II 224)	Committee's 1962 prediction (II 249)	Actual (III 274)
1962	$3,124,000	$3,500,000	$3,802,000
1963	3,124,000	4,090,000	4,356,000
1964	3,124,000	4,775,000	4,779,000

As pointed out supra p. 47 ff, profits were managed and manipulated and do not afford a basis for comparison.

The growth that occurred is reflected in these figures from the successive plan hearings (II 225;230;222;224;III 78;97;145;274):

	Ships	Sailings	Trailers	Revenue
Plan II	3	50	331	$3,024,000
Plan III	5	101½	670	4,779,000

Additional improvements made or in active preparation included:

implications of the paradoxical fact that although it was now said to be "more insolvent" than in 1962, the enterprise was now able to borrow $1,250,000 which it could not do in 1962. Then it was explicitly stated that if the company had to pay the government in full, it could not do so, although it could borrow $500,000 and pay the government 30 or 40 cents on the dollar (II 327, 373).

This loan, we may note parenthetically, was offered by a banking group of which the trustee was director. The loan conditions originally tied the loan to retention of the trustee as management (III 244,266). Investigation of this matter called for by the committee under § 221(3)(4)(5) was denied (III 244-5,266).

From the point of view of the valuation of the company, this bank loan is extraordinary in that, if the bank saw the trustee's figures and believed them, it was lending $1,250,000 payable at $300,000/year plus interest at 6% (in the first year this amounts to $366,750) to an enterprise that the trustee contended in 1962 would earn $206,000/year (II 353) and was now in 1965 even "more insolvent" (III 266). The bank got security it is true, but this was the plainly illusory security of rapidly deteriorating special purpose equipment (II 14-18,101-104,127,223,III 78,174), virtually worthless on a foreclosure and valuable only to the extent that it produced earnings. Since banks do not ordinarily make loans so dangerously improvident, even to assure soft berths

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(a) New model trailers for initiating railroad "piggy back" interchange with railroads—first purchase $100,000 (III 174-5, 286).

(b) Testing of refrigerated trailers (III 308)

(c) Studies for new improved vessels (III 61-63,144-148,233)

(d) Patent application re TMT's lashing system—estimated saving $30,000-$35,000 per year (III 194-195)

(e) Contract service to Navy installation in the Bahamas (III 175-7)

to good friends who sit on their boards, the question must be faced whether the trustee gave the bank a truer picture of the earning power of the company than he has chosen to give the record. If not, this is a repeat of the classic manoeuvre of the eve-of-bankruptcy mortgage.

The court's conclusions, in the face of this evidence, and of this refusal to investigate, and of the persistently incorrect approach, do not reflect the business realism that Chapter X requires.

POINT III - Stockholders victimized by the debtor's participation in stock flotation fraud should have been considered for creditor treatment.

In 1960, albeit reluctantly, the trustee had investigated the committee's 1958 charges of fraud and 1959 charge that Shaffer-Spitzer was Abrams' front. The investigation proved those charges and turned up the new and significant fact that not only had Abrams et al. defrauded the company but as insider financial advisers they had led the company into itself committing a series of stock flotation frauds—unindependent accountant's financial statements, balance sheet inflation by the Wilmington and Bellanca deals (I 261,263-4, 269-70).[45]

A. Public stockholders have a valid claim against the company.

From these facts there could readily be developed the view that under the federal securities laws the company's participation in the stock flotation conspiracy made the company itself liable to innocent stockholders who had bought unregistered stock from Abrams-Shaffer-Erdman, or who bought from third parties in the manipulated market,

[45]The committee later charged additional such stock flotation frauds (II365ff) including the fraud in Maritime Administration discussed in connection with the trustee's failure to investigate, supra, p. 26; continued use of an offering circular no longer true; stockrigging publicity about the Carib Queen. (I 260,261,271).

even without privity with the issuer company. The committee contended that the stockholders were entitled to creditor treatment by reason of those frauds and statutory violations. The first record statement of this position was by the SEC and by the trustee himself in his February 1961 objection to the Shaffer-Spitzer claim.

> "The claim should be disallowed in toto or be subordinated to the claims of *general creditors, including stockholders* who were sold TMT stock in violation of the Security Act of 1933 and the Securities Exchange Act of 1934" (II 1096, our emph.; cf. II 1093).

Because of the special importance of this problem to the SEC, as indicated in the Solicitor General's memorandum in support of our petition for certiorari p. 19 ff., we leave to the briefing we assume the SEC will make any elaboration of the substantive principle here involved, both as to the right of public stockholders to claim against the issuer under the doctrine of the bank receivership cases such as *Oppenheimer v. Harriman etc. Bank,* 301 U.S. 206; and as to the unimportance of privity in federal securities law violations suits under such cases as *Fischman v. Raytheon Mfg. Co.*, 188 F2d 783 (CA2); *Hooper v. Mountain States etc. Corp.*, 282 F2d 201 (CA5); *Texas Continental etc. Co. v. Dunne,* 307 F2d 242 (CA6). We address ourselves therefore to the question particular to the posture of this case, whether the claim was presented too late.

B. The courts below erroneously held the claim presented too late.

In the Plan III proceedings now under review the court of appeals affirmed the district court's rejection of the stockholders' claim without reaching the merits of the claim, on the ground of laches. It held the proofs of claim filed by the committee and by an individual stockholder on behalf of herself and her class both barred by the district court order of February 4, 1958. This order had required proofs of all claims to be filed by April 4, 1958, two months away, except that as to claims "founded upon securities", the bar date was put off

to "the time to be fixed herein within which the creditors and stockholders affected thereby may accept the plan" (147). Holding that the exception in the order contemplated contract claims only, rather than a tort claim or right of rescission, the court of appeals held that the bar date applied in terms and that "no valid reason or excuse is given for the delay from July 1960 [discovery of the claim] until June 1962 [filing of the formal proofs of claim]" and since the liquidation of the claims might have taken years the district court had discretion to refuse to reopen the bar date and to decline to consider the merits. *Protective Committee etc. v. Anderson*, 364 F2d 936, 939-40. The bar order in this case came out of a form book[46] and must be applied to a set of facts which have no form book precedent. If the stockholders' claim is one "grounded upon securities", the bar date has never passed. If not, but the stockholders could reasonably have so understood it, it clearly ought to be reopened. In any case the district court has power to reopen it upon a showing that facts essential to the assertion of the claim were not known at the time the bar date passed in 1958. That is clearly the case where, as here, trustee and district court refused to believe the fraud even worth investigating although insistently urged to do so, until 1960, and the securities law violations were not known until the trustee's investigation and report in July 1960. Reorganization cases decry Procrustean treatment of bar dates. *In re United Cigar Stores Co. of America*, 82 F2d 744, 745 (CA2) Cf. *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 226-228, and dissent at 235. See also cases collected 6A *Collier on Bankruptcy*, ¶ 9.03. Cf also H. Report 1409 (75th Cong., 1st Sess.) p. 46.

Indeed, assuming for the moment that the bar date had passed and that the Committee was barred by laches from obtaining a reopening of it, the substantive issue is of such importance, the effect upon scattered public stockholders of such consequence, and the fairness and equitableness of the

[46] *7 Collier on Bankruptcy*, ¶ 2202

plan so plainly involved, that the district court was bound to raise and consider the questions we brought to his attention, sua sponte, and if they have some measure of validity, to reopen the bar date without our request. *Comstock* supra; cf. *Young v. Higbee Company*, 324 U.S. 204, 214.

1. The appropriate bar date had not yet passed.

Trade creditors or even tort claimants have had particularized transactions with the debtor, which can be and should be stated early under traditional bankruptcy doctrines so that these claims can be totted up. But public security holders are on a different footing and are traditionally treated differently. The fact that they are scattered and usually ignorant of their rights and of the procedures for defending them was one of the reasons that led to the Chapter X reforms and to the emphasis there on protective committees to act for security holders. (aboye p. 21). It would be absurd to compel the committee to comply at this stage with the formal requisite of a proof of claim that it identify each stockholder by name, address and certificate number for purposes of a securities law claim any more than for a claim to a piece of the equity. Debenture holders' claims are computed on the basis of a maximum amount estimated outstanding, whether or not they have filed, for purposes of a plan; and so they were here (I 47-8). Stockholders' rights to recover what they paid in the market are likewise adequately computable to a maximum for working purposes by recourse to transfer records and to readily available quotation sheets. The bare possibility that the maximum so set might be imprecise is no reason not to set it at all. Hence until the right asserted by the committee is vindicated in principle on the crucial facts common to all public stockholders, there was and will be no point to putting either the committee or the estate to spending money to encourage and perhaps mislead scattered stockholders into the difficult task of documenting rights not yet established. In the light of these considerations, the construction of the bar date order as not barring the claim better serves the purposes of

the statute. But if the bar date applies, then imperative considerations of equity require that it be reopened.

2. The finding that the claim came too late was erroneous in the absence of hearing.

The formal proofs of claim were filed in June 1962, and the Plan II approval order rejecting them was filed in July. But there was no pleading response at all to the committee claim, and the trustee's motion to strike the individual claim was never noticed for hearing, so that the district court disposed of both ex parte (II 4,368,370). The question whether the 1958 bar date should apply to these 1962 proofs of claims since it could not be decided against the stockholders merely by matching dates, was a question of fact, of laches. This the court of appeals recognized even in deciding against the stockholders on the point:

> "No valid reason or excuse is given for the delay from July 1960 until June 1962. To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to liquidate and which might have delayed indefinitely the formulation of any plan of reorganization, would have been extremely prejudicial to the creditors." (364 F2d, at 940)

In this quoted treatment of the laches question there are two errors, one of fact and one of law.

As to fact, the court here fails to mention that long before the filing of the June 1962 formal proofs of claim the committee had picked up the trustee's June 1960 disclosure of the facts and his February 1961 indication of the basic theory of the claim. This was explicit in the committee's Statement of Position, presented in March 1961, i.e., before the appeals from Plan I had been disposed of. It recited the claim and included an application for extension of the bar date: but it was rejected as premature, with leave to file later (II 861,962,1039).[47] The trustee did not extend

[47]The court of appeals decision on Plan I, 292 F2d 455, had not yet come down; and this Court's denial of certiorari to Shaffer-Spitzer

his statutory invitation for plan suggestions under § 167(5,6) until February 6, 1962 (II 659), shortly after certiorari on Plan I was denied. Then another unequivocal announcement of the committee's assertion of the claim took place in February 1962, in timely response to the trustee's invitation.[48] The court of appeals, in criticizing the committee for filing *too late* in June 1962 overlooked not only the February 1962 Suggestions but also the March 1961 Statement and application for extension of bar date, a document rejected by the district court as filed *too soon.*

As to law, the court of appeals in the quoted passage turns the laches on the observation that the individual claims "might" have taken years to liquidate and so might have prejudiced the creditors by preventing the formulation of a reorganization plan. The committee's proposed amendments to the plan (II 1087) had asked the district court to set aside a maximum block of new common stock for old stockholders, a simple and practical way of providing for recognition of the claim while leaving it to the stockholders to fight out later their total overall participation within this maximum and which of them should get what within that total, all without interference with the immediate issuance of new common stock to acknowledged general creditors. This is the commonplace machinery of issuing stock subject to a maximum dilution in favor of someone else, that may or may not ever come to pass.[49] Laches, it is elementary,

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on Plan I, 368 U.S. 956, did not come down until January 1962. Until that date Plan II development necessarily marked time.

[48] Suggestions for the Formulation of a Plan, (II 1083, filed Feb. 16, 1962). Our Amendments to the Plan (II 1090, filed June 18, 1962); Objections and Amendments to Cash Plan (II, 1087, filed June 18, 1962), were filed at substantially the same date as the proofs of claim: they indicate the variety of our assertions of the position.

[49] Suggestions for working out the mechanics by which liability in principle is determined first and intervention of individual claimants permitted later are supplied by *Union Carbide & Carbon Corp. v. Nisley,* 300 F2d 561(CA 10); *York v. Guaranty Trust,* 143 F2d 503 (CA2); *Derdiarian v. Futterman Corp.,* CCH Fed Sec L. Rep. ¶ 91.575 (SDNY, 1965).

requires both a finding of unjustified delay and a finding of detriment. We submit that in view of the earlier several presentations of the claim there could be no fair claim of filing delay; and that on the facts of the committee's proposal there need be none of the detriment by hypothetical future delay envisaged by the court of appeals. But both these questions are questions of fact, and deciding the issue of laches without opportunity to have them weighed at an adversary hearing on notice, this Court has made plain, is error of principle for which it will reverse a court of appeals:

> ". . . there was never an opportunity for Czaplicki to introduce evidence to justify the delay * * * [N] or has there been opportunity to prove * * * that the delay has in no way prejudiced the respondents. These are questions on which the parties should have been allowed to present evidence. The present record is inadequate to justify a holding that this action was barred by laches." (*Czaplicki v. The Hoegh Silvercloud*, 351 U.S. 252) 533-534.

POINT IV - The trustee's conflict of interest invalidates the proceedings and taints the reorganization plan.

A. Trustee independence is the basic assumption of Chapter X reorganization.

One of the reasons for the enactment of Chapter X was to remedy the abuses resulting from "friendly trustees" (Sen. Rep. No. 1916 on H.R. 8046, 75th Cong., 3rd Sess. 21-22(1938). "* * * The independent trustee is the key to real reform. In comparison the other reforms are secondary" (SEC Comm'r Douglas, Hearings before H.R. Committee on Judiciary, on HR 6439, p. 177 (1937).

The independent trustee makes possible impartial investigation of pre-reorganization misconduct, impartial consideration of alternative plans, and impartial scrutiny of the allocation of control and the affiliations of new management. Only through an impartial and independent trustee can the court be in a position to exercise an "informal judgment and to afford a critical scrutiny and supervision of the estate

at all times" (H.R. Report No. 1409, 75th Cong., 1st Sess., 43 (1937).

"As a general principle, the trustee and his attorney engaged in the conduct of the reorganization proceeding should be free of the slightest personal interest which might be reflected in their decisions concerning matters of the debtor's estate or which might impair the high degree of impartiality and detached judgment expected of them during administration." (6 *Collier on Bankruptcy* p. 2003 (14 ed., 1947).

Sec. 156 of the Act requires that a reorganization trustee be "disinterested." § 158(4) provides that a trustee is not "disinterested" where it appears that he has, ... for any reason an interest materially adverse to the interests of any class of creditors or stockholders."

B. This trustee has acquired a personal interest in the reorganization plan sponsored.

Formulation of three successive plans under his trusteeship has been followed by his designation each time as president and director. Ever since the "mutually satisfactory conclusions" (I 40) with Shaffer-Spitzer in Plan I which resulted in the trustee's becoming president, the trustee has had a personal stake in the reorganization: a management contract and stock options, firmly committed or transparently understood. Under Plan I, he had only one seat out of 9 on the board controlled by Shaffer-Spitzer. Under Plans II and III however, the trustee and his staff will have 3 places out of 7 on the board and for most management decisions will be in practical control of the reorganized company since 2 places are filled by his patronage beneficiaries and the last 2 by the protected accused creditor Merrill-Stevens.

Plans II and III are additionally predicated on the trustee's continued connection with the reorganized company. Loan commitments were concededly essential to plan feasibility (Plan II, $500,000, II 314,331; Plan II, $1,250,000, III 12, 25). In Plan II, a tie-in loan, offered by Florida Towing, a patronage beneficiary, and one by a banking group of which

the trustee was himself a director, were explicitly conditioned on his management (II 314,319-22,331; expurgated 748, 749). In Plan III, a larger loan was offered by a member of the trustee's banking group. Although the Plan II tie-in condition was in less explicit words, it was clearly understood (III 24, 244). The trustee admitted that he had made no effort to get loans from independent sources, free of this condition (II 322).

C. The trustee's personal interest in the reorganization plan resulted in conflict of interest that taints the plan.

"Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting" *Mosser v. Darrow*, 341 U.S. 267, 271. For this reason, we join the SEC in believing that a prophylactic rule is called for, barring trustees from aspiring to major office in the reorganized company.

On the facts of this case however, we urge that even if this Court should not sustain the absolute bar, it is utterly clear that this trustee on the facts of this reorganization cannot serve and did not serve the estate and the parties evenhandedly, free of bias from the expectations and understandings and hopes he entertained of support from certain major creditors, and free of interest adverse to the stockholders.

The trustee has consistently chosen reorganization plans that favor him. In 1958-59 the choice was between the Shaffer-Spitzer plan that retained him as president and the Florida Towing plan which did not (I 113, 183; 114); he argued against Florida Towing and adopted as his own the Shaffer-Spitzer plan (I 117, 135, 163).

In 1962-63 the choice was between an "internal" stock plan which similarly offered him a job, and a cash plan which did not. The trustee argued against the cash plan and the bidders desisted. This time Florida Towing was an ally, and through claim-buying, was enabled to cast a substantial vote in favor of the "internal plan".[50] It was rewarded with a

[50] For Plan III, Florida Towing's vote was essential: 70% of class 6, a blocking vote, plus 11% of unsecured claims.

place on the board and a sweetheart towing contract now running to $1,500,000/year.

The trustee's choice in each instance was self-serving. We cannot prove that he was influenced only by his personal advantage, but - - -

". . .the incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent," See also *Woods v. City Bank Co.*, 312 U.S. 286, 368, which denied compensation to a fiduciary in a Chapter X proceeding where a conflict of interest existed, though no fraud or unfairness was specifically shown to have resulted.

Where the conflict exists, there need be no speculation whether the result was

- to close the record of Merrill-Steven's past transactions where investigation was needed.

- to compromise the Shaffer-Spitzer and Merrill-Stevens claims where vigorous assertion of counterclaim was necessary.

- to delay or abandon suits where speed was essential to prevent tolling of the statute of limitations.

- to bestow insider contracts where competitive bidding would have been more economical.

- to delay or refuse information until outside investors give up in disgust where encouragement might have benefitted the estate.

The district court here recognized that the trustee, faced with a choice between the "internal" plan which offered him employment and a cash plan which did not, "would be perhaps inclined to lean to his employment" (II 332)

but failed both at that point or generally to hold the trustee to the high standard required by this court in *Wolf v. Weinstein*, 372 U.S. 633, where a severe remedy was found necessary:

> "***one who exercised control over a reorganization holds a post which might tempt him to affect or influence corporate policies—even the shaping of the very plan of reorganization—for the benefit of his own security holdings but to the detriment of the Debtor's interests and those of its creditors and other interested groups".

Though this language applied to the president of a debtor in possession under Chapter X who had traded in the debtor's securities, the reasoning is at least as applicable to a reorganization trustee who trades in undertakings of future employment. A trustee who, while trustee, considers or is approached with the suggestion that he become the president must make a choice. He must either in clear terms reject the suggestion and remain as trustee—or he may entertain the suggestion and resign as trustee for he can no longer be impartial.

POINT V - The reorganization has been conducted in substantial disregard of the statutory function of the SEC.

Chapter X sought to abate the evil of equity receiverships by vesting in the district judge new opportunities and new duties to protect the scattered public investors from insider exploitation in reorganizations. Scarcely less crucial to Chapter X effectiveness than the independent trustee as the reorganization judge's dedicated investigator and reporter of reorganization facts both prospective and retrospective, is the SEC as the reorganization judge's expert adviser. The SEC gets automatic notice of all steps in all Chapter X cases, § 265; with the reorganization judge's approval it becomes as here (I 25) a party to the case for all purposes except initiating appeals, § 208; and in any case with over $3,000,000 debts as here the judge must (and in smaller cases he may) submit the reorganization plan to the SEC for examination

and report before he approves it for submission to vote of the parties, § 172. We have noted in passing that the SEC's views were much like those of the committee on many issues of the case; and on no major issue at any stage initial or appellate did the SEC take a position in opposition to that of the committee. But the point of particular importance is that the SEC's advisory reports had specifically warned the district court against each of the major errors we complain of here.

The SEC's reports criticized the spurious "compromises," the retrospective valuation technique, the trustee's lack of independence, the rejection of the stockholders' creditor claim without hearing.[51] More important still than the fact

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[51] "In estimating the foreseeable future earnings, weight must be accorded to past earnings only insofar as they are indicative of future earning power" (SEC Advisory Opinion on Plan II (II 729).

"The trustee's approach to earnings of the Debtor as a basis for valuation as a going-concern was unduly restrictive. The record of the valuation hearing clearly indicates that the trustee has proceeded upon the erroneous basis that, for purposes of arriving at a going-concern value, the Debtor is assumed to remain in reorganization, and thus is to be valued 'as it now exists,' rather than 'when reorganized'. The effect of this narrow view was to restrict the development on the record of foreseeable possibilities of increasing revenue or reducing expenses, and confined the projection of earnings to a consideration of only the status quo." (II 733)

"The demonstrated need for the additional vessel highlights the trustee's failure to give effect to reasonable foreseeable expansion of the Debtor's business." (II 734)

"Unless the potentialities of expansion of the Debtor's business are properly explored for the purpose of valuation, we have no adequate basis upon which to test the sufficiency of the cash offers. Finally, although we are not prepared to state what the Debtor's enterprise is reasonably worth, the facts thus far developed provided no justifiable basis upon which to conclude that the stockholders have no equity in the Debtor. We conclude that this record does not contain adequate and reliable evidence of value for the purpose of determining the fairness of the plan." (II 735)

that the SEC reported these errors before confirmation, each of its reports rests on some 25 pages of fact analysis far more detailed than that of any judicial opinion in the record. (II 722ff.;III 215ff.) Each report points to specific

"In light of the trustee's report, the treatment of the Caplan mortgage is not fair or proper. There is nothing in the record to justify the trustee's retreat from this prior position in his report." (II 739)

"Both plans deny stockholders participation on the assumption the Debtor is insolvent, while at the same time effecting compromises allowing some $2,000,000 of seriously contested claims. Since the effect of both plans is to exclude the stockholders on an inadequate valuation record, and in the light of the treatment of the Merrill-Stevens claims and the Caplan mortgage, neither plan is fair and equitable." (II 741)

"The independence and impartiality of the trustee is the very essence of the reorganization process under Chapter X, and must be strictly maintained throughout the proceeding. The prospect of the trustee obtaining a remunerative position with the reorganized company after termination of the trusteeship tends to impair the disinterestedness required of him as trustee. In the course of the proceeding the trustee is called upon to make many decisions and recommendations that are of substantial importance to the reorganization, such as the type of plan to recommend, the prosecution or settlement of claims, and many other matters. In all of these, it is essential that the trustee maintain complete impartiality, uncompromised by any personal interest in the outcome of the reorganization." (II 743)

"In view of the inadequacy of the record, there is no reliable basis upon which to resolve the question of valuation. While the fair and equitable standard does not preclude a proper compromise of claims, the treatment accorded by the plan to the Caplan mortgage and the Merrill-Stevens claim represents no genuine compromise." SEC Advisory Opinion on Plan III (III 235)

"Whether or not such liability [to public stockholders] can be demonstrated depends upon proof of facts which the Court did not permit the Stockholders Committee to present." (III 238)

"The record does not warrant a finding that the plan is fair and equitable in view of lack of adequate evidence as to valuation; the allowance of seriously disputed claims without hearing and the summary rejection, without hearing, of the stockholder claims for fraud." (III 242)

items of evidence in the record on which the SEC conclusions rest. These views of the SEC have particular importance by contrast with the analysis used by the court of appeals in its affirmance of Plan III notwithstanding its stated recognition that the district court had been in error in treating as approved law of the case all those features of Plan II embodied in Plan III.

We need not dwell on obviously rhetorical makeweights in the court of appeals opinion, although we deem them patently erroneous. The assertion as to Shaffer-Spitzer and Merrill-Stevens that–

> "The persons most directly affected by those compromises were other creditors, and it is significant that not a single creditor has ever complained of either compromise" (364 F2d at 941).

is one such error. Even though only a trivial fraction of the creditors objected (III 324,326), this Court holds that overwhelmingly heavy acceptance by creditors will not cure a plan in conflict with the basic Chapter X requirement of fairness. *Case v. Los Angeles Lumber Prod. Co.*, 308 US 106. The now vacated Shaffer-Spitzer Plan I, it will be recalled, was also based on a "compromise" to which not a single creditor failed to acquiesce. I 40,42-43.

Likewise the court of appeals' dismay at the inordinate length of the proceedings:

> "This nine-year-old litigation must at long last be brought to an end" (364 F2d at 941).

cannot fairly militate against the stockholders. Three years were wasted before Plan I was finally set aside for failure to heed the committee's warnings against Shaffer-Spitzer. It took two years more to vacate Plan II for the erroneous district court ruling on government priority, a matter on which the committee took no sides. The committee, because its financial means are limited, has even more reason to deplore the delays brought about by the trustee's failure to follow the plain mandate of the law. It should hardly require even reminder citation that speedy injustice becomes no juster

for being faster. Had the court of appeals decided Plan I or Plan II on the issues raised by the committee, either the stockholders would have been long buried and the case over, or the trustee would not have taken license in Plan II and the district court in Plan III to repeat the errors that provoke the present Plan III appeal.

The basic ground for the court of appeals' treatment of Plan III was not these makeweights. It pitched the affirmance, rather, on the standard appellate doctrine of the presumption of correctness of trial court action, as applied to both the insolvency finding and the refusal to consider stockholders as creditors, which are the operative rulings that exclude stockholders from the reorganization.

As to setting a bar date and finding the stockholders in laches on asserting their creditor claim, the affirmance was on the ground that this was within trial court "discretion," 364 F2d at 940. As to insolvency and the compromises of creditor claims in the face of fraud, the affirmance was on the ground that the insolvency finding was not demonstrated "clearly erroneous;" at 941. We think that we have shown above, in the specific Points devoted to those matters, that the rulings complained of passed the traditional borders of the harmless error doctrine. But in any event, in a Chapter X case the district court's findings do not come to appellate review clothed with the heavy presumption of regularity accorded to most trial court action. When the SEC exercises as here its statutory option to participate in a reorganization by way of appearance, advisory reports, and joining in appeals, the shoe may be on the other foot. As the Second Circuit put it in *Conway v. Silesian Amer. Corp.*, 186 F2d 201, at 202-203 (CA2), where the presumption of trial court regularity was unsuccessfully urged in support of approval of a compromise plan the SEC had found—as here—unfair:

> "But we are not justified in thus oversimplifying this difficult problem, so much more one of forecasting the future than of restating the past. Naturally care-

> ful consideration is due the conclusion of the able district judge who has had this lengthy reorganization so long under his control. At the same time we cannot overlook the fact that the governmental agency charged with substantial responsibility in the premises, the Securities and Exchange Commission, had made an extensive investigation resulting in a detailed and helpful report with *a reasonable conclusion which the trial judge has rather summarily rejected.* If the considered findings of this agency with so much better facilities for investigation than those possessed by either this or the trial court, are to have any force beyond their initial impact below, then we think that they will *largely offset the usual presumption accorded a decision of first instance.* Otherwise much of the statutory purpose in creating an expert body for the consideration of technical problems will be set at naught. Compare 6 Collier on Bankruptcy 7.30, 14th Ed. 1947. We have elsewhere stressed the importance of due regard for Commission findings, Finn v. Childs Company, 2 Cir., 181 F2d 431,438; and we are clear that here, too *we must give weight to the detailed evaluation of the facts made by this reliable and experienced public agency and to the conclusion reached, even though this was not accepted by the trial judge".* (our emph.)

See also on the counterbalancing effect of the SEC views, *Ashbach v. Kirtley,* 289 F.2d 159 (CA8); *Scribner and Miller v. Conway,* 238 F2d 905 at 907 (CA2); *In re Solar Mfg. Corp.,* 215 F2d 555 at 562 (CA3); *Chicago & West Towns Rys. v. Friedman,* 230 F2d 364 (CA7).

We noted at the beginning of this Point that Chapter X gave the district court, sitting in reorganization, new specialized expert assistance. The SEC's reports are advisory. We do not suggest that they bind the court, but they should guide and enlighten the reviewing court even if and perhaps because the reorganization court has rejected them. Where the reorganization court has failed to make crucial investigations required by the statute, has acted precipitately without

hearing any evidence on the fact of laches, and has misweighed the legal effect of valuation evidence on a record that excluded essential evidence on the fact issue of insolvency, all in violation of plain teaching of this Court; where, moreover, the SEC has pointed out in detail not only the particulars of the errors but also the incalculable overall blight cast upon the proceeding by the unindependent trustee,[52] we submit that the reorganization court's errors may not be saved as within such routine ideas as "discretion" and "not clearly erroneous." Under those circumstances, we submit, it is the responsibility of the reviewing court to face up squarely to the major errors alleged, weigh them in the light of the statutory policy that the SEC as the statutory expert says has been nullified, and enforce that policy.

CONCLUSION

We grounded our petition for certiorari largely in the failure of the court of appeals to give guidance to the distrct court for the curbing of the trustee, whereby that court and its officer were encouraged to treat as approved any points on which the court of appeals failed specifically to reprimand when it vacated the first two plans. Because we have complained of so broad a range of interlocking and cumulative error, amounting indeed to an effectively total

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[52] SEC advisory opinions are quoted supra p. 66 n. 51. Additional objections include:

Plan I	SEC objections to approval I 123
	SEC objections to confirmation I 169
	SEC objections to creditors' petition I 197
	SEC objections to consummation I 216,219,231
Plan II	SEC objections to confirmation II 757,862,874
	SEC objections to consummation II 889
	SEC motion to stay consummation II 979
Plan III	SEC objections to confirmation II 325

disregard of the major protections of Chapter X, reversal on one or a few of the available narrow issue errors will not serve for guidance in this reorganization, or in others. We have selected from the broad range of error in this reorganization the four critical errors which deflected the past course of the reorganization: those we presented as the Questions that opened this brief. If they are answered in the spirit of Chapter X, the reorganization court will be required to let the available facts on the stockholders' alleged past laches and on the company's past and present and future, to come into the record and be informedly considered; it will be made plain that the reorganization must be rid of the trustee who has kept so many of these facts out of the record and has demonstrated his overall lack of independence. Curative steps of detail—e.g., the review of the towing contract and the compromises, the reinstatement of the discharged committee, putting an end to the deliberate suppression of facts—all this may then be reasonably expected to fall into place.

Respectfully submitted

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,
Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,
Respondent.

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

This brief will respond to both the Brief for Petitioner and the Brief for the Securities and Exchange Commission.[1]

[1]Petitioner will sometimes be referred to as the stockholders committee and the Securities and Exchange Commission as the SEC.

STATUTES INVOLVED

The following sections of the Bankruptcy Act (11 U.S.C. 1 et seq.)[2] are involved in addition to those listed in the opposing briefs:

Section 27. *Compromises.* The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.

Section 209. Any creditor or stockholder may in a proceeding under this chapter act in person, by an attorney at law, or by duly authorized agent or committee.

Section 210. An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Section 211. Every person or committee, representing more than twelve creditors or stockholders, and every indenture trustee, who appears in the proceeding shall file with the court a statement, under oath, which shall include—

* * * * * * *

(4) a showing of the claims or stock represented by such person or committee and the respective amounts thereof, with an averment that each holder of such claims or stock acquired them at least one year before the filing

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[2]Hereafter the references will be only to sections of the Bankruptcy Act and not to U.S.C. section numbers.

of the petition or with a showing of the times of acquisition thereof.

Section 216. A plan of reorganization under this chapter—

* * * * * * * *

(13) may include provisions for the settlement or adjustment of claims belonging to the debtor or to the estate; and shall provide, as to such claims not settled or adjusted in the plan, for their retention and enforcement by the trustee or, if the debtor has been continued in possession, by an examiner appointed for that purpose.

QUESTIONS PRESENTED.

Regarding the issues concerning the officers and directors of the reorganized company:

1. Whether the "law of the case" doctrine should be applied and the determination of these issues by the Fifth Circuit in 1964 recognized by this court without further consideration of their merits.

2. Whether the provisions in the plan of reorganization authorizing the reorganized company to employ the trustee and his subsequent employment by the directors of the reorganized company and election to its presidency are precluded by Chapter X of the Bankruptcy Act.

3. Whether after the plan of reorganization has been substantially consummated and the trustee and his management team have been employed to operate the reorganized company the employment of the trustee can be attacked without any efforts having been made to disqualify the trustee as such.

Regarding the issues with respect to the compromise of the Merrill-Stevens and Caplan mortgage claims:

4. Whether these claims were adequately investigated and whether the record discloses sufficient facts with respect to their basis and the objections to them to enable the district judge to render an informed decision on the compromises.

Regarding the issue concerning the insolvency of the debtor:

5. Whether there is substantial competent evidence to support the district court's finding of insolvency.

6. Whether the district court gave proper consideration to the future earning prospects of the debtor.

Regarding the issues concerning the alleged stockholder rescission claims:

7. Whether the claims were timely filed and filed in good faith by Petitioner.

8. Whether the facts in the record with regard to the issuance of stock by TMT indicate that stockholders who purchased their stock on the open market can properly assert rescission claims against the debtor and recover their losses from the debtor estate.

9. Whether rescission claims by stockholders of TMT would necessarily be subordinate to the claims of creditors.

Regarding the discharge of the stockholders committee:

10. Whether the discharge was proper since the debtor had been found insolvent.

STATEMENT OF THE CASE

The statement of the SEC, including its history of the proceedings, is accurate as far as it goes except for one sentence that is misleading. On page 8 of its brief, the SEC says: "Under the plan Merrill-Stevens, in conjunction with the trustee and his general manager, would have gained initial control of the reorganized company." This is misleading because there are seven directors of the reorganized company initially appointed by the court and, of course, any four of them constitute a majority and could "control" any decision that the directors are required to make. There is nothing in the record to suggest that the two persons from Merrill-Stevens together with the trustee and his general manager since their appointment have constituted a clique to run the reorganized company. Ultimate control is in the common creditors who have become the new stockholders and will hereafter elect directors of their own choosing.

The statement of the case in Petitioner's brief contains so many half truths and misleading and inaccurate statements that we are including our comments on them in an appendix at the end of this brief. It will suffice to recognize here that Petitioner's brief is replete with inflammatory verbiage and unnecessary innuendo which we will comment on further to the extent necessary in our argument.

This has been an unusual reorganization in several respects. The reorganization trustee has been highly successful in operating a business that during its brief existence prior to the beginning of the Chapter X proceedings had been wrecked by gross mismanagement. Claims

against the debtor totaled more than $5,400,000. (II 288)[3] When the trustee took over in November, 1947, the business was at a standstill, the three old World War II LSTs which it owned were in rundown condition needing repairs and no traffic was moving. (I 30) The success of the trusteeship enabled the court eventually to approve a plan of reorganization (III 260, 271) that provided for the payment in full of all preferred and secured claims[4] and turned the company over to its common creditors who exchanged their claims for the new common stock. The total face amount of these claims, after reclassifying the Merrill-Stevens lien claims as unsecured was in excess of $3,800,000. (II 288)

The unsecured creditors have been enthusiastic about this "internal" plan from the beginning and it is difficult to conceive of a more fair and equitable one. None of the cash offers for the assets of the debtor were ever seriously considered by any of the creditors because, as we will show under Point 4 c of our argument, these cash offers guaranteed little or nothing for the creditors while the internal plan gave them ownership of a business that had been successful under the trustee.

The internal plan, along with the compromises of the two largest lien claims that made the plan feasible, was originally proposed by the Creditors Committee representing unsecured creditors as a class (II 41-42) and was accepted in 1962 by these creditors over the cash plan by an 83.37% affirmative vote. (II 898) When the amended internal plan was sent out for approval in 1965 it was ac-

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[3]References to the record will be the same as the Petitioner uses, i.e. the records in the three appeals to the Fifth Circuit will be cited as "I", "II", and "III", respectively. (See Petition, n. 1, p. 2)

[4]Before the Merrill-Stevens and Caplan mortgage compromises these totaled more than $2,200,000. (II 288)

cepted by more than 95% of the unsecured creditors. (III 316) This increased acceptance of the plan after three more years of operation, not as successful financially as in 1961 and 1962 (discussed under Point 4 a below), reflects the confidence that all concerned had in the basic fairness of the plan and the conduct of the business by the trustee.

The statements of opposing counsel imply that the trustee has not pursued causes of action against persons responsible for the mismanagement of TMT before the reorganization proceedings began. The truth is, as everyone involved well knows, that two suits were brought to recover damages against many of the persons responsible. An action in the Southern District of Florida resulted in a final judgment against Eric Rath, the founder and "daddy" of TMT who was its president and dominated its activities. This judgment, in amount of $131,850.25 was entered October 16, 1963[5] and we have been unable to recover anything on it. The other case is pending in the Southern District of New York[6] and is against Joseph Abrams, Leo Levy, Irving M. Panzer, Robert M. Erdman, Whippany Center Corporation, and Joseph P. Day, Inc. It seeks to recover more than one million dollars in damages for fraudulent stock transactions and other irregularities arising out of the purchase by the debtor of property at Wilmington, Delaware. More than $13,000 has been spent by the debtor on fees and costs in this suit, which amount does not include expenses of the trustee and his counsel in connection therewith, but nothing has been recovered to date in that suit.

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[5]Case No. 11,267, *Anderson* v. *Rath*, in U.S. District Court for the Southern District of Florida.

[6]Case No. 61-Civ.-4639, *Anderson* v. *Abrams*.

SUMMARY OF ARGUMENT

1. The provisions in the plan of reorganization permitting employment of the trustee by the reorganized company are lawful and proper.

The decision of the Fifth Circuit on this issue in 1964 became "the law of the case" and should not be considered again in the current review of the plan since the provisions in the present plan on the subject are identical with those upheld in 1964 and the persons, including the trustee, approved in the former plan to initially operate the reorganized debtor are the same as those approved in the current amended plan. The Fifth Circuit has refused to reconsider its former decision on the subject and this court should refuse to disturb it because the trustee and the new management have taken over the operation of the business of the debtor and are operating it properly and without objection from the creditors (now new stockholders) concerned.

No provisions of law preclude the trustee from being employed by the reorganized company. The opposing contention that an interest in such employment necessarily as a matter of law means that the trustee has an interest adverse to the interests of creditors and stockholders cannot be sustained by proper construction of the statutes and in this case is contrary to the facts because it is obviously in the best interests of the reorganized company to retain the valuable services of the trustee and none of the creditors concerned have objected to this employment. The issue is one to be determined under the facts and circumstances of each case under Section 221(5) of the Bankruptcy Act and the decision here of the district judge and of the directors of the reorganized company should not be disturbed. The court of appeals has correctly upheld the

provisions in the plan on the ground that they do not assure the trustee of employment but merely put everyone on notice that he may be considered.

The opposing contention is based on interpretation of statutes relating to the *qualifications* of the *trustee* (Sections 156 and 158, Bankruptcy Act) and not on the provision governing the officers and directors of the reorganized company. (Section 221(5))

No effort has been made by anyone to disqualify the trustee during the many years that he has served while every plan of reorganization under consideration has contemplated his possible employment by the reorganized company. The present plan has been substantially consummated in fact and the effort to prevent the trustee from serving the reorganized company comes too late. The issue of his disqualification to serve as trustee should have been squarely presented years ago to the district court if the opposing contention is valid, and it should not now be held to vitiate the entire plan of reorganization.

2. The district court's approval of the directors of the reorganized company was lawful and proper.

The identity, qualifications and affiliations of the seven persons recommended by the creditors to be the officers and directors of the reorganized company were fully disclosed to the district court and their approval under Section 221(5) of the Bankruptcy Act is based on a record sufficient to satisfy the district judge that their appointment was in the best interests of the debtor. Neither Petitioner nor any other party has urged the appointment of any other persons.

3. The provisions in the plan of reorganization for the Merrill-Stevens and Caplan Mortgage claims were arrived at after intensive investigation and a prudent evaluation of the results and of the law, and reflect a fair adjustment of the equities.

Compromises of claims are normal and necessary in reorganization cases as this court has frequently held. They are expressly authorized by statute and should not be disturbed except upon a clear showing that the district court abused its discretion in approving them or acted arbitrarily. Objections to claims do not have to be heard or litigated where, as here, a compromise of the issues raised is included as an integral part of the plan of reorganization and extensive hearings are held on the fairness and equitableness of the plan.

The objections to the two claims were subject to intensive investigation by the trustee and his counsel, by the SEC, and by Petitioner. The results of these investigations were fully reported to the district court and the record contains an abundance of facts with respect to the claims and the objections thereto, sufficient to enable the court to render an informed decision on the merits of the compromises.

These claims asserted liens against the vessels of the debtor in excess of one milliion dollars and the litigation of the objections would have been expensive and time consuming, of highly uncertain outcome, and would have delayed unduly the preparation and processing of a plan of reorganization. The compromises were proposed by a Creditors Committee as a part of its "Internal" plan of reorganization and their approval was recommended strongly by experienced counsel for the trustee who had studied thoroughly the facts and issues involved and had

carefully weighed the probabilities of successful litigation over the objections.

The compromises satisfied lien claims of more than one million dollars for $250,000 with the remainder reduced in amount and exchanged for common stock in the reorganized company. This made the internal plan feasible and removed the last stumbling block to the prompt formulation of an acceptable plan. The unsecured creditors, the only real parties in interest, almost unanimously accepted the plan and none objected to the compromise of the two claims. The stockholders have no standing to object to the compromises because the debtor is insolvent and the compromises affect only the equity of the common creditors. If the two claims were to be disallowed *in toto* the debtor would still be insolvent. Dissenting stockholders of an insolvent company should not be permitted to impede a plan of reorganization desired by creditors unless they are willing and able to pay the costs of delay and extended litigation.

4. The district court's finding in insolvency was clearly correct and its determination of reorganization value was based on substantial and competent evidence.

Insolvency hearings were held before the district judge in 1962 and in 1965 when the plan of reorganization was under consideration. Extensive testimony was taken on the issue, including that of two expert witnesses who dealt with the future prospects of TMT. A complete record was made of the results of 7 years operation of the business by the trustee. There was an abundance of substantial and competent evidence to support the district court's finding of insolvency which was based on claims of more than $5,400,000 as against assets valued at less than $2,000,000 and a going concern value of $2,780,000.

The charge by opposing counsel that the district judge did not consider all relevant facts concerning future earning capacity is not sustained by the record. There is extensive testimony in the record by the trustee, his general manager, and the two experts on the subject. The district judge properly refused to require the trustee to make speculative estimates of future earnings based on operations after the acquisition of expensive new vessels requiring major new financing and possible changes in methods of operation, these being matters that could only be determined after reorganization by the new owners of the company. The evidence shows that the debtor has experienced a decline in earnings since the first finding of insolvency was made in 1962 and that any more recent estimate of going concern value would result in a figure less than the $2,780,000 finding made then.

Cash bids received by the district court for all the assets of the debtor do not indicate an erroneous finding of going concern value because these bids required the debtor to pay all the current liabilities of the trusteeship. Furthermore, they were decisively rejected by the creditors concerned.

5. Stockholders are not entitled to participate in the reorganized company on a parity with common creditors.

The reorganized proceedings have lasted ten years and no stockholder has filed any claim except counsel for the Petitioner. If the Stockholders Committee is supposed to represent stockholders having *claims* it is required by law to list the names of the claimants it represents and state the amount of the claims so the trustee and others interested can intelligently prepare a plan of reorganization. The unknown claims that Petitioner seeks to assert in a "class" claim are unliquidated in amount and arise out of

transactions on the open market to which the debtor was not a party. If there are any such claims, Petitioner should have filed them long ago and had ample time to do so after it became aware of facts upon which such claims might have been based. Instead, the Petitioner waited until *after* all the hearings had been held in 1962 for consideration of the fairness and feasibility of the plans under consideration to file the class claim and the one rescission claim of Mrs. Mason, one of Petitioner's attorneys. Up to that time, Petitioner had represented stockholders as such, and not as claimants, and the shifting of position can be explained only because it had become apparent that the debtor was insolvent and there would be no equity for stockholders. We therefore charge the Petitioner with not filing the alleged rescission claims in good faith and the district court properly refused to consider them for good cause as stated in its order. Petitioner wants the court to *invite* stockholders at this late date to file rescission claims and there is no provision of law authorizing such a procedure where such claims are grounded in tort, are unliquidated in amount, and each would be based on different facts and circumstances.

There are insufficient facts in the record to indicate that rescission claims against this debtor could lie. The facts in the record indicate to the contrary. There is no privity between such claimants and the debtor since the stock was purchased on the open market. The facts reported in the Trustee's Report of Investigation, which is quite complete on the subject, indicate that the debtor was the victim and not the perpetrator of the alleged fraudulent stock transactions which might give rise to rescission claims by open market purchasers of the stock. The securities acts and regulations thereunder remove the necessity for showing privity in rescission claims of this kind only to enable the guilty party to be reached. The guilty parties

are Abrams, et al. none of whom were officers or directors of TMT. The facts in the record are sufficient to sustain the district judge's finding that the alleged rescission claims were factually insufficient.

If rescission claims were allowed they would necessarily be subordinate to the claims of creditors. The set of facts disclosed by the record which caused the downfall of TMT, mismanagement connected with possible misrepresentation of assets and fraud in connection with issuance of stock, injured both creditors and stockholders, and where the assets are insufficient to satisfy both classes of claims, the latter must give way to the former under the strict priority rule of this court. The authorities sustain our position on this and the cases cited to the contrary by the SEC arising under the National Bank Act are not applicable because stockholders of national banks have unusual liabilities and are allowed priority status with creditors *by statute* under certain circumstances. The equities of the TMT situation require that defrauded stockholders be subordinate to defrauded creditors. Since the debtor is insolvent it would be useless to invite the filing of claims by stockholders.

6. The discharge of the stockholders committee was proper.

Since the debtor is insolvent and the plan of reorganization expressly provides that stockholders have no equity in the reorganized company, and the plan has been confirmed and largely consummated, there is no further need for the committee. The committee has been expressly authorized to prosecute appeals so no rights of stockholders have been prejudiced by discharge of the committee.

ARGUMENT

1. THE PROVISIONS IN THE PLAN OF REORGANIZATION PERMITTING EMPLOYMENT OF THE TRUSTEE BY THE REORGANIZED COMPANY ARE LAWFUL AND PROPER.

The success of the trustee in operating the business of the debtor made it almost inevitable that any group responsible for continuing the business after reorganization might want to retain the services of the trustee and the efficient management team that he had put together. His general manager, employed with the approval of the trial court, was B. E. Thouvenelle who had worked with the trustee for many years when they were in the retail merchandising business.

Counsel for the SEC stated in open court at the hearing in 1963 to consider consummation of the plan:

> There is no question that Mr. Anderson and Mr. Thouvenelle and their staff under the guidance of the court have done a wonderful and remarkable job in rehabilitating the debtor and operating it successfully. Mr. Anderson represents proven management and should be considered. (III 995)

Each plan of reorganization, as pointed out by opposing counsel, contained a provision authorizing the continuation of the trustee's services. Before the present internal plan was proposed and while interested parties were considering various proposals, the Creditors Committee appointed by the trial court to represent unsecured creditors as a class, filed a report on February 1, 1962, "to furnish information which the Creditors Committee believes will be of aid to any person desiring to submit a proposal for a Plan of Reorganization." (II 650) This report contained among other recommendations the following:

MANAGEMENT

> Of Course, if the payment to unsecured creditors is all in cash, management in the future would be unimportant to them. However, if any plan was submitted whereby it would be proposed that unsecured creditors take any portion of their claims in deferred payments or stock or securities of the reorganized company, the unsecured creditors would insist that as a part of the plant, that good and proper management be guaranteed. *This could include present management if such be proposed.* It is therefore suggested that if the proponents of any plan contemplate deferred payments or issue of stock or securities of the reorganized company to the unsecured creditors, that the plan specifically set forth the details about management. (Emphasis added) (II 652-653)

This Committee consisted of Harold Friedman and Paul G. Hyman, two attorneys with extensive experience in bankruptcy and reorganization matters and they have represented in these proceedings the interests of unsecured creditors as a class and particularly the mass of small creditors.

Thereafter, this Creditors Committee submitted on March 30, 1962, for consideration a Plan of Reorganization which was substantially the same as the Internal Plan now before this court. (II 41-42) They were the authors of the plan and *not* the trustee as implied in Petitioner's brief. Their plan stated that "It is necessary that competent management, which might include present management, be employed to operate the reorganized company . . ." and provided for certain shares of the new common stock to be reserved in connection with employment contracts with officers or management. It also provided that "The terms of any such contract which would be acceptable to present management if their services be

desired shall be requested and made available for inspection and discussion by the court and by any interested party at the time of the scheduled hearing on April 25, 1962." (II 41.11)

The purpose of the last quoted provision was to put everyone on notice that the creditors proposing the plan were considering the advantages of retaining the services of the trustee and his team and to meet the requirements of Section 221 (5) of the Bankruptcy Act that the identity and affiliations of persons who are to be directors or officers of the reorganized company be fully disclosed.

The plan as finally approved and confirmed contains this provision:

> f. The identity, qualifications and affiliations of the proposed initial officers of the reorganized corporation shall be reviewed by the Court prior to consummation of the Plan and the election of such persons to be such officers by the Directors will be subject to a determination by the Court under Section 221 (5) of Chapter X that their appointment to such offices is equitable, compatible with the interests of the creditors and stockholders of the reorganized corporation, and consistent with public policy.
>
> 7. It is necessary that competent management, which might include present management, be employed to operate the reorganized company and that any such management contract is to be approved by the new Board of Directors and the court. (III 257)

The district court order of July 11, 1962, approving the plan stated:

> The SEC memorandum also objected to the provision in the Internal Plan which contemplates that the reorganized company may employ the Trustee as its president. This provision, however, is not manda-

tory on the reorganized company and was inserted at the insistence of the court for the purpose of making full disclosure of what had come to the attention of the court. Both the Trustee and the creditors' committee had advised the court that certain of the largest unsecured creditors who favored an internal plan wanted the present management retained. There is nothing in the law which precludes a trustee from accepting employment from the reorganized company, and certainly the creditors concerned are entitled to insist on good management acceptable to them. (II 378)

Thereafter this plan was accepted by a large majority of the creditors[7] and the following were nominated by certain of the creditors for appointment as the initial seven man board of directors for the reorganized company: C. Gordon Anderson, B. E. Thouvenelle, Gardner T. Gillette, James C. Merrill, Jr., W. T. Coppedge, Jr., Shelby P. Langston, and Rafael Martinez-Alvarez. (II 978)

These directors were well known to the court and to all others concerned. Anderson and Thouvenelle were the trustee and his general manager; Gillette and Merrill were prominent Jacksonville businessmen who were affiliated with Merrill-Stevens; Coppedge was a Jacksonville businessman with Florida Towing Corporation, one of the major creditors; Langston was a leading Miami insurance agent and a creditor; and Martinez was the attorney for the debtor in Puerto Rico. (III 352-354) No others were suggested for consideration by the court except the attorney for one creditor whom the trustee presented to the court but who was satisfied with those named and agreed to their appointment. (III 355-356)

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[7]70.9% of the lien claimants and 83.37% of the unsecured claimants accepted the plan. (II 388 and 892)

The Order of Confirmation entered February 14, 1963, stated:

> 16. The identity, qualifications, and affiliations of the persons who are to be directors and officers and voting trustees, if any, upon the consummation of the said plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, will be equitable, compatible with the interests of the creditors and stockholders and consistent with public policy. (III 886)

It is apparent that it was known from the inception of the plan that the trustee and his manager were to be considered for employment and affiliation with the reorganized company, that the creditors concerned desired such affiliation and that there were no objections thereto from any real party in interest. All procedures required by law for proposing, identifying and selecting the initial directors of the reorganized company were carefully followed, especially those requiring notice and hearing.

The Fifth Circuit approved what had been done, holding that the trustee under the facts and circumstances here was not disqualified to serve the reorganized company and that his contemplated presidency of it did not vitiate the plan. *In re TMT Trailer Ferry, Inc.*, 334 F.2d 118 (1964).

The Fifth Circuit remanded the case only for further consideration of the feasibility of the plan, and thereafter the plan was amended only to provide for payment of the United States non-tax claims in full. There was no change made in the plan with respect to the management provisions and again in 1965 the same directors were proposed and approved by the district court after the amended plan had

gone through the prescribed procedure of approval, acceptance by the creditors, and confirmation.[8]

a. This issue was decided by the Fifth Circuit in the prior appeal and the decision should not be disturbed by this court under the "law of the case" doctrine.

As previously stated, this issue regarding the employment of the trustee was fully presented to the Fifth Circuit in the 1964 appeals involving the plan of reorganization and that court resolved the issue contrary to the contentions of Petitioner and the SEC. The affirmance of this part of the plan thereby became "the law of the case" and since it was not appealed to this court or otherwise changed the same decision should be permitted to stand.

When the plan came back to the district court in 1964 and was amended, it is significant that the SEC recognized that the issue had been settled. The SEC filed a lengthy report on the amended plan (III 215-242) but it made no comment on the subject except to note that the Fifth Circuit 1964 opinion "sustained the provisions in the Internal Plan with respect to the employment of the Trustee as president of the reorganized company." (III 223) Nor did the brief filed by the SEC in the appeal of the present plan to the Fifth Circuit discuss the issue of the employment of the trustee.

The district court's opinion and order approving the amended plan (III 260) did not discuss the issue *because it was not raised.* The record shows that when the matter was heard (III 351-357) the court asked twice (III 356)

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[8]See Opinion and Order Approving Amended Plan (III 260) and Order Confirming Internal Plan of Reorganization as Amended. (III 328) See also Order in Aid of Consummating Plan of Reorganization. (III 389)

if there were any comments or objections to the names of those proposed for appointment as the new directors of the reorganized company and there were none *even from counsel for the Stockholders Committee* who was present. The Trustee, of course, was one of the new directors.

The plan was taken by Petitioner back to the Fifth Circuit and that court mentioned in passing that Petitioner had again raised the issue "whether the plan should be rejected because the Trustee would become President of the reorganized company". Then the court said "The issue last stated was decided on that appeal in accordance with the decision of the district court," referring to its 1964 opinion. *Protective Committee* v. *Anderson*, 364 F.2d 936, 939 (1966).

It is apparent that all parties, except Petitioner here, including the district court and the appellate court considered that the 1964 opinion of the Fifth Circuit settled the issue.

> "This rule of 'the law of the case' is a salutary rule, necessary as a matter of policy in order to end litigation. It is based upon the ground that 'there would be no end to a suit if every obstinate litigant could, by repeated appeals compel a court to listen to criticisms on their opinions, or speculate of chances from changes in its members.'"
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> *General American Life Ins. Co.* v. *Anderson*, 156 F.2d 615 (6th Cir. 1946).

> A decision of an appellate court in a given case is said to be "the law of that case" and no question decided therein will be decided in a subsequent appeal in that case unless there are compelling reasons presented for the court to reverse its prior position.
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> *Ira Haupt & Co.* v. *Klebanow*, 348 F.2d 907 (2d Cir. 1965).

This court has said:

> In the absence of statute the phrase, "law of the case," as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided, not a limit to their power.
>
> *Messinger* v. *Anderson*, 225 U.S. 436, 444.

The circumstances in this case clearly call for the application of the "law of the case" doctrine. The plan presently before this court is identical, insofar as the trustee's employment by the reorganized company is concerned, as the one approved in that respect by the 1964 decision of the appellate court. There is no compelling reason for overturning the decision three years later, but many reasons for allowing it to stand in this case. These reasons are:

1. The creditors concerned want to retain the valuable services of the trustee and his management team who have been highly successful in operating the business of the debtor.

2. The district court has approved what amounts to substantial consummation of the plan and has turned the operation of the business over to the new directors. Pursuant to Order in Aid of Consummating Plan of Reorganization entered May 25, 1965 (III 389-395), the trustee has issued nearly all the 1,300,000 shares of new common stock to the creditors entitled to it, the new directors have met and formally approved the $1,250,000 loan authorized in the plan and that loan has been consummated and its proceeds used to pay the creditors entitled to be paid in cash.[9]

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[9]Most of this money was used to pay in full the claims of the United States totaling approximately $1,097,000. (III 224)

The plan required *the reorganized company* to borrow this money (III 254) so it was necessary for the new directors to organize and execute the necessary loan documents. What is even more significant is that the new directors have taken over from the trustee responsibility for operating the business of the debtor, and all of the assets of the debtor have been transferred to the reorganized company. (III 340-344, 393-395) The new directors have employed the trustee and his general manager to operate the business at the same salary previously authorized by the court.

3. The best interests of the debtor require the continuation of the valuable services of the trustee. His success and capabilities have never been challenged and it would be detrimental to require the reorganized company to seek new and untried management. The best example of benefits derived from the trustee's success is that it has enabled all preferred and secured creditors to be paid *in full.* In the early years of the trusteeship the United States agreed to settle its non-tax claims of more than $900,000 for 27½% thereof in preferred stock of the reorganized debtor. (II 559-564) This was in 1959 but six years later the success of the business had been such that the government insisted on being paid in full in cash and this has been done.

The factors outlined above clearly show that the "law of the case" should be applied here and that there are no impelling circumstances requiring an exception to the rule. Control of the reorganized company has become vested in the management desired by the creditors concerned and to throw out this management at this late date would not be wise and could be disastrous to the company.

b. Chapter X of the Bankruptcy Act does not preclude the trustee from being employed by the reorganized company.

No court has held that the trustee may not be employed by the reorganized company. The Memorandum for the Securities and Exchange Commission filed by the Solicitor General in support of the petition herein (Case No. 952, October Term, 1966) lists in the footnote on page 9 other cases in which a Chapter X trustee has succeeded as president of the reorganized company.[10]

Congress specified in Section 158 of the Bankruptcy Act who shall be deemed a disinterested trustee and failed to state that an interest in employment by the debtor after reorganization is a disqualification. The SEC argues that if the trustee is being considered for future employment by the reorganized debtor, it necessarily and as a matter of law makes him a disinterested trustee.

This argument is not sound for it presumes that the trustee will breach the trust imposed in him. It engages in the assumption that as a matter of law a trustee who *intends* or *contemplates* that he will become president upon reorganization *necessarily* has an interest adverse to the interest of creditors and stockholders. This assumption belies human nature for a person with an incentive will do a better job than one marking time knowing there is no future for him. In any event, as the Fifth Circuit decision held, the TMT Trustee is not *assured* of future employment but his job depends entirely on the new directors.

Nor did Congress ever intend to make the test of "disinterest" dependent upon the subjective *intention* or *con-*

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[10]These cases are *In the Matter of F. L. Jacobs*, E.D. Mich., No. 42235; *In the Matter of Yuba Consolidated Industries*, N.D. Cal., No. 64103; and *In the Matter of Inland Gas Corp.*, E.D. Ky., No. 115.

templation of the trustee. The statutory tests in Section 158 of the Bankruptcy Act are all objective tests, and the SEC would write into the section words and meanings that are not there.

The argument of opposing counsel overlooks the benefits that the debtor might derive from being permitted to use the abilities of a successful trustee. It overlooks completely that fact that all actions of the trustee are subject to review and approval by the federal court, and the record in this highly contested proceeding indicates that all material decisions have been the subject of action by the court after hearing all interested parties.

Congress was given an opportunity in 1938 to write into Chapter X of the Bankruptcy Act a prohibition against a trustee or his attorney being employed by the reorganized company for a period of two years after substantial consummation but failed to act on the bill. This was emphasized on pages 11 and 12 of our Reply of Respondent to Memorandum for the Securities and Exchange Commission filed herein under date of May 16, 1967, and is admitted in footnote 30, page 31 of the SEC brief herein on the merits.

It is apparent that the SEC would have this court, in effect, add a provision to the law which Congress has not determined is necessary or desirable.

The Fifth Circuit placed the proper interpretation on the statute when it held that a trustee would not be disinterested unless "the proponents of a plan assured him of emoluments and security rather than merely nominating him for approval by the court and subject to the usual control of the Board of Directors." (334 F.2d at 119-120) There is no such assurance here as the plan clearly states.

c. There has been no attempt to disqualify the trustee because of his interest in employment by the reorganized company.

If the position urged by opposing counsel is correct, the trustee has been disqualified to serve for many years. The original plan of reorganization approved in 1959 was confirmed by an order expressly approving the trustee as president of the reorganized company. (II 517) We have previously shown that in the very inception of the present plan in 1962 the creditors who proposed it contemplated the employment of the "present management" including the trustee.

Nevertheless, there has been no motion to disqualify or remove the trustee, no motion to appoint an additional trustee, no effort made to refuse compensation to the trustee on the ground that he has a conflict of interest or violated his trust. Everyone has been content with the trustee's successful operation of the business.

It is too late *now* to urge that the *past* disqualification of the trustee precludes the reorganized company from employing him. The plan has been, in effect, substantially consummated, as previously shown. If the plan is otherwise valid, it would be inequitable to preclude the new owners of the company from using the valuable experience of the trustee.

Petitioner and the SEC are estopped now to prevent the employment of Mr. Anderson because they have failed throughout this proceeding to urge his replacement as trustee on the ground that he was disqualified to act. The statutes on which opposing counsel rely relate only to the qualification of the trustee as such and do not pertain to his right to be employed by the reorganized company. The latter is covered only by Section 221(5) of the Bankruptcy

Act which requires the court to confirm a plan if satisfied that "the identity, qualifications, and affiliations of the persons who are to be directors or officers . . . have been fully disclosed, and that the appointment of such persons . . . is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

The district court has made an affirmative finding under the above quoted section of the law (III 330) based on the facts and circumstances relating to this trustee. The court was never given an opportunity to test the *disqualification* of the trustee to act as such. It is too late now to raise the issue that he has been a disinterested and therefore disqualified trustee for many years.

2. THE DISTRICT COURT'S APPROVAL OF THE DIRECTORS OF THE REORGANIZED COMPANY WAS LAWFUL AND PROPER.

The SEC has made no attack on these directors, other than the trustee, either in this court or the lower courts.

Petitioner, however, with the invective which permeates its entire brief makes wholly unfounded charges against directors other than the trustee. We have previously identified these gentlemen and shown that their affiliations and qualifications were well known to the district judge and to all parties who were concerned with the proceedings, and that their selection was based on nomination of them by certain of the creditors. (II 978)

Pages 38 and 39 of Petitioner's brief contain insinuations that there was something improper in the activities of directors Coppedge and Langston buying the claims of others at a discount. The truth is that these transactions were all fully recorded and approved by the district judge without objection from anyone. The trustee and his attor-

ney were kept fully aware of them and the trustee called their existence to the attention of the court. (II 867)

Petitioner has not included in the record brought to this court all of the many petitions and orders entered approving the subordination of claim purchasers,[11] and it is improper to cast aspersions on these purchasers with no complete record here of the transactions as they are disclosed in the district court files.

Petitioner makes an unwarranted assumption in Point 1C, page 36 of its brief, that there are improper affiliations within the new management. Petitioner in the court below merely charged, in unsworn objections by counsel to approval of the plan, using vague generalities that there should be an "investigation" of "the Trustee's affiliations" with others interested in the debtor. (III 244-245) However, there was nothing to investigate as the material facts and circumstances were either spread upon the record or otherwise well known to the trustee, his counsel, the court, the Petitioner and all others who inquired.

The Fifth Circuit did not consider this issue worthy of discussion and there is certainly an insufficient record here to justify setting aside the district judge's approval of the new directors.

It is also significant to note that no party, including Petitioner, has suggested that any of the new directors be replaced, nor did Petitioner make any suggestion to the court as to who the directors should be.

Regarding that part of Petitioner's brief, page 38, which attacks the award of a towing contract to Florida Towing Company, it will suffice to say that this contract was the subject of several hearings before the district court

[11]Only 2 are in the record here. (II 667, 680, 754 and 755)

and several orders approving it[12] but *no appeal has been taken* in these proceedings from any of such orders. The orders pertain only to matters relating to the operation of the business of the debtor and not to the plan of reorganization. Petitioner's appeal which is the subject of this review is only from the order confirming the plan (III 340) and other orders unrelated to the operation of the business. (III 395 and 396)

We are confident that the court will recognize the impropriety of the numerous instances in which counsel for Petitioner has made shotgun charges of wrongdoing on the part of nearly everyone connected with the promulgation of the plan of reorganization.

3. THE PROVISIONS IN THE PLAN OF REORGANIZATION FOR THE MERRILL-STEVENS AND CAPLAN MORTGAGE CLAIMS WERE ARRIVED AT AFTER INTENSIVE INVESTIGATION AND A PRUDENT EVALUATION OF THE RESULTS AND OF THE LAW, AND REFLECT A FAIR ADJUSTMENT OF THE EQUITIES.

This court, speaking through Mr. Justice Douglas, has stated that the compromise and settlement of claims is not only an allowable procedure in reorganization cases, but is often a sensible and desirable course to pursue,[13] and that "compromises, settlements, and concessions are a normal part of the reorganization process".[14]

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[12]One of these orders is in the record here. (II 70)

[13]*Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106.

[14]*Institutional Investors* v. *Chicago, M. St. P. & P.*, 318 U.S. 523, 565.

The Bankruptcy Act Section 27, authorizing compromises of claims with the approval of the Court, applies to Chapter X, and such compromises may be effected separately during the proceeding, or in the body of the Reorganization Plan as expressly provided in Section 216(13).[15] *In re Associated Gas & Electric Co.*, 61 F. Supp. 11, aff'd 149 F.2d 996, cert. den. 326 U.S. 736; *Fernow* v. *Gubser et al.*, 136 F.2d 971 (10th Cir. 1943); *Collier on Bankruptcy*, Vol. 6A, par. 8.07, pp. 28-32; *Remington on Bankruptcy*, Vol. 2, Sec. 1155, pp. 634-645.

The approval of a compromise is an exercise of judicial discretion, which should not be disturbed unless the court acted arbitrarily or clearly abused its discretion. *Daniel Hamm Drayage Co.* v. *Willson*, (8th Cir. 1949) 178 F.2d 633, 635; *Fernow* v. *Gubser et al.*, supra; *In re Prudence Co.*, 98 F.2d 559 (2d Cir. 1938), cert. den., sub. nom. *Stein* v. *McGrath*, 306 U.S. 636; *In re Kalamazoo Bldg. Co.*, 21 F. Supp. 852 (1937).

It is clearly not required that the court litigate objections to claims (*In re Kalamazoo Building Co.*, supra), nor adjudicate the issues raised thereby (*In re Prudence Co.*, supra), before it may approve a compromise of such claims. The court need not evaluate the respective chances of success of the claimant or the trustee in connection with compromises. *In re Midland United Co.*, (D.C. Del. 1944) 58 F. Supp. 667, 681.

In the case of *In re Prudence Co.*, supra, the court after stating that the District Court did not determine the validity of the government's claim with respect to the taxability of the "commissions" and "nor need this court do

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[15]General Order 33, cited by Petitioner (Brief p. 32), is not applicable where the compromise and settlement of claims is embodied in the Plan of Reorganization. Collier, *Bankruptcy* (14th Ed.), par. 8.07, Vol. 6A, pages 31-32.

so", said "The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, . . ." (98 F.2d at 560).

To the same effect is *Florida Trailer & Equipment Co.* v. *Wiley R. Deal,* 284 F.2d 567 (5th Cir. 1960).

It is important to note that *no creditor* has objected to the provisions in the reorganization plan for the compromise of these two claims. That is true both in the two appeals to the Fifth Circuit and in the proceedings here. There were numerous hearings prior to the approval of the plan and its confirmation both in 1962 and in 1965 but at none of them did any creditor voice or file any objection to the Merrill-Stevens or Caplan settlement provisions. We have previously pointed out that the creditors accepted the plan by overwhelming vote in 1962 and in 1965.

The unsecured creditors were the parties benefited by the settlements. The Caplan preferred ship mortgage claim was reduced in amount and the Merrill-Stevens maritime lien claims of $574,000 were reduced to unsecured status. The equity of the unsecured creditors was thus materially increased and an early plan of reorganization made possible. Likewise, it was the unsecured creditors who stood to gain if the claims could be materially reduced by litigating the objections to them. They were the real parties in interest—not the stockholders since the debtor was insolvent.

The brief for the SEC (p. 40, footnote 37) urges that the Fifth Circuit decision on review here erroneously attached significance to the fact that the creditors had not complained of the compromises, citing as authority *Case* v. *Los Angeles Lumber Products Co., Ltd.,* 308 U.S. 106, 114. That case is not in point because it involved settle-

ment in the plan of reorganization of a claim by stockholders that they were entitled to an equity in the reorganized company. This court held in *Case* that the strict priority rule precluded stockholders from being given any such equity where the debtor was clearly insolvent even though a big majority of the creditors approved cutting in the stockholders for a small slice of the equity, and that even a creditor who was among the small minority that did not approve the plan could have it set aside as not being fair and equitable to him.

The situation with TMT is quite different. The two compromises affect only one class—the unsecured creditors—and their acceptance of it is a material factor to consider as against the objections of an inferior class, the stockholders.

The compromises were first proposed as an integral part of the internal plan of reorganization submitted by the Creditors Committee. (II 41.5-41.6) These compromises eliminated the two largest lien claims against the vessels of the debtor.

The basis of the arguments by the SEC against the approval of the compromises is that "The record contains no evidence, upon which the merits of these claims could be evaluated, or upon which the district court could have made the 'informed, independent judgment' . . . which is necessary for approval. . . ."[16] In addition, the Petitioner claims that there was inadequate *investigation* of the facts with respect to the claims and the objections thereto. Neither of these contentions can be sustained by the record.

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[16]SEC brief, pp. 36-37.

The Merrill-Stevens Claim

The record contains an abundance of pleadings and allegations concerning the facts with respect to the Merrill-Stevens claim. These facts are stated in sufficient detail to enable the trial court to render an informed decision on the merits of the compromise of the claim. The facts with respect to the claim are in the following portions of the record:

(1) Proof of Claim filed on April 1, 1958, by Merrill-Stevens. (Not printed in the record but outlined at II 22-23)

(2) Facts asserted in letter dated Nov. 10, 1958, from counsel for the Stockholders Committee to Judge Choate with respect to defects in the work done on the Carib Queen. (I 130)

(3) Facts outlined in the trustee's Report of Investigation filed July 1, 1960, with respect to the construction and breakdown of the Carib Queen. (I 270-271)[17]

(4) Objections of the SEC to the claims of Merrill-Stevens and Shaffer-Spitzer, filed January 20, 1961. (Not in the record here but referred to in the index, II 2)

(5) Specifications in Support of the objection of the SEC to the Merrill-Stevens claim, filed September 1, 1961. (II 405-411) This was based on an investigation by the SEC of the Merrill-Stevens claim.

(6) Answer of Merrill-Stevens to the above Specifications of the SEC, filed September 1, 1961. (II 1098-1101)

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[17]This motion states that the trustee had agreed to settle the Merrill-Stevens claim in 1959 "following an examination of the debtor's records which indicated that work had been performed on the vessels as indicated in the claim". (II 23-24)

(7) Motion for Allowance of Claim, filed by counsel for the trustee on December 31, 1961. (II 22-26)[18]

(8) Objections of the United States to the above motion, filed January 18, 1962. (II 647-649)

(9) Hearing in open court on the above motion, January 23, 1961. (II 35-40)

(10) Specification of Objections to the Claim of Merrill-Stevens, filed by the Stockholders Committee on February 12, 1962. (II 1042-1072.4) This was based on the Stockholders Committee investigation of the claim.

(11) Statement of the SEC in Support of Stockholders Committee Contentions re Merrill-Stevens Claim, filed February 16, 1962. (II 1073-1074)

In addition to the facts detailed in the documents listed above, the trustee and his counsel had available and examined numerous documents assembled by the SEC during its investigation of the claim and they also examined statements made by individuals and numerous documents furnished by Merrill-Stevens. None of this data is shown in the record, but the examination of it was reported to the court by the trustee and his counsel. (II 25)

The documents listed above show that there were at least four investigations of the Merrill-Stevens claim: (1) the trustee's investigation in 1959 with respect to the work performed on the vessels, (2) the SEC investigation in 1961, (3) the investigation made by counsel for the trustee in 1961 based on documents from the SEC investigation and

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[18]Additional facts developed in testimony taken during the investigation were filed with the trial court but are not in the record here.

others received from Merill-Stevens, and (4) the Stockholders Committee investigation of 1962.

While all of the documents examined and persons interviewed in these investigations are not shown in the record, the results thereof were reported to the court as outlined above and are shown in the record. Of particular benefit were the very thorough investigations made by the SEC and the Stockholders Committee which are reported in great detail. (II 405-411 and 1042-1072.4) In addition to the facts reported in these investigations, the district court was influenced by the impartial and objective analysis made of the claim and the objections thereto by counsel for the trustee (II 22-26) who advised the court "that the possibility is remote of obtaining any reduction, or material reduction, in the amount of the Merrill-Stevens claim by litigating the objections filed against it" (II 25-26) and that "a fight of the issues would be time-consuming and expensive to the estate and would result in unnecessary delay in forming a Plan of Reorganization." (II 35)[19]

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[19]As an example of the type of information which the trustee's counsel examined during his investigation, which does not appear of record, was the written report submitted by the SEC of an examination of Coast Guard records pertaining to the Carib Queen breakdown made by a Navy chemical engineer, Edward Wagman, which includes these conclusions:

d. The ship's crew on each incident of failure and prior thereto appears to have been either wholly responsible or at least culpable to a great extent.

e. The responsibility of Merrill-Stevens for the casualties which occurred after January, 1957, is beyond a reasonable and fair appraisal of the facts at hand.

f. The possibility of attributing the cause of the first casualty to Merrill-Stevens exists and although there is a closer causal-connection to it than to subsequent casualties, it is a rather flimsy connection and the probabilities have to be stretched beyond their likelihood.

Without detailing the issues with respect to the objections to the claim as these are thoroughly aired in the opposing briefs, it will suffice to point out it is undisputed that Merrill-Stevens did extensive work on the vessels of the debtor for which it has not been paid and that all the issues concerned its *tort liability* for the results of its work and whether some of the work done could properly give rise to maritime liens against the vessels. The compromise released lien claims against 5 of the vessels totaling $574,580.35 (II 41.6) and provided for payment of these claims only in common stock of the reorganized company. Thus, the largest lien claims against the vessels were satisfied without using any of the cash needed to insure the feasibility of the plan.

The Caplan Mortgage Claim

The facts and circumstances with respect to this claim are thoroughly documented in the Trustee's Report of Investigation. (II 579-617) Most of the investigation concerned the Caplan mortgage and, as stated in the footnote on page 44 of the SEC brief, the investigation covered 14 days of hearings, testimony of 33 persons covering 2200 pages, and more than 60 exhibits.

The district court had before it for consideration in connection with the proposed compromise the Trustee's Report of Investigation, a lengthy answer of Shaffer-Spitzer, Trustees, to the report of investigation (I 298-304), the several objections filed to the claim, the claim itself, and the recommendations of the Creditors Committee, the trustee and trustee's counsel favoring the settlement. These are all in the record here, but in addition the district court had the full record of the trustee's investigation, which is not in the record brought to this court.

Trustee's counsel recommended approval of the Caplan settlement for substantially the same reasons as for the Merrill-Stevens settlement, namely that the settlement was a reasonable one under the circumstances, that litigation of the objections was uncertain and would be costly and would unduly delay reorganization. (II 661-662)

Regarding the merits of the claim, the trustee's investigation report discloses that the debtor on May 31, 1957 executed and delivered to Caplan, as trustee, and there were promptly recorded, two first preferred ship mortgages on three unencumbered barges and on the ship "Cuba" in the face amount of $330,000, payable January 1, 1957 without interest, and in the event of default with interest at the rate of 6% and all legal expenses, and convertible into common stock at the option of the holder on the basis of one share for each $1.25 principal amount. The sum of $280,500 in fresh capital was paid for the mortgages, and an additional $49,500 was paid for 49,500 shares of common stock. The total sum of $330,000, which was so paid by the participants in the Caplan group, was disbursed primarily to meet an installment due on a mortgage on a different vessel (the Carib Queen), to satisfy a mortgage, libels, and claims against two of the vessels mortgaged to Caplan, and to pay recording fees, and the balance was utilized by the debtor for working capital. (II 599-600)

If valid and enforceable according to its terms, Shaffer-Spitzer, trustees, would be entitled to be paid in cash the aggregate of $330,000, plus 6% interest for over 6 years or in excess of the additional sum of $120,000, plus legal fees and disbursements in a presently undetermined but substantial amount. By the time of consummation, the cash outlay would materially exceed $500,000, or would involve a substantial cash outlay plus delivery of assets vital to the debtor and its business.

In contrast, the plan of reorganization provides for payment of $250,000; the past due interest on $280,500 from January 3, 1958 is to be allowed, but only as an unsecured claim. (II 693-694)

It will be noted that (a) the principal amount of the claim is reduced by $80,000; (b) no legal fees are payable to or for the attorneys for the creditor, nor is it reimbursed for any part of its very substantial expenses incurred in this proceeding; (c) the accrued interest, instead of receiving priority treatment along with the principal is subordinated to the status of an unsecured claim; (d) unlike other holders of maritime liens, the Caplan mortgage holders are not afforded the privilege of converting the principal amount of their claim into new stock of the reorganization debtor, except that with respect to past due interest it will receive stock on a parity with unsecured creditors, which will amount to a miniscule percentage of the total participating claims (II 288); and (e) the holders of the Caplan mortgages will have no representation on the board of directors (II 987) and no meaningful say in the affairs of the reorganized debtor other than that of a small minority stockholder.

The District Court's Findings

It is readily apparent that the district court had before it a thorough record concerning the facts and issues with respect to the compromises of these two claims. The order of the court approving the plan of reorganization discloses that its decision to accept the settlements was the result of a prudent evaluation of the law and of the facts and circumstances involved. The court said in its 1962 order:

> While the vessel valuation proceedings were in progress and before any of the lien adjudication and

marshalling proceedings had begun, the trustee and the unsecured creditors committee appointed by the court to represent that class of creditors were given informal permission by the court to contact the principal lien and priority claimants for the purpose of attempting to compromise and settle the issue involving such claims. This was deemed wise because it was apparent that the liquidation of the issues involved, particularly the objections to the Caplan and Merrill-Stevens claims, would take possibly years to conclude and it was the opinion of the court as well as the trustee and the creditors committee that the financial success of the trusteeship required the early reorganization of the debtor if at all possible.

Negotiations by the trustee and the creditors committee resulted in proposed compromises of the Caplan mortgage claim and the Merrill-Stevens claims, which compromises are included in the Internal Plan of Reorganization, initially filed by the creditors committee. It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders Committee is too remote for serious consideration. If the unsecured creditors approve the Internal Plan with these compromises, the only class that can object are the stockholders, and the court has found in the Valuation and Insolvency Order that the stockholders have no equity even if these two claims were disallowed in toto. The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act. (II 372-373)

Three years later Petitioner asserted that it had uncovered more facts concerning the Merrill-Stevens claim (III 16-20) and the material allegations with respect to them were denied under oath by Merrill-Stevens. (III 69-70) A hearing was held on the matter (III 83-88) during which counsel for the trustee advised the court that the further "witch hunt" by the Petitioner had not shown any good cause for further consideration of the settlement. The court agreed and rejected the effort to reopen the matter (III 73-74) and after several further hearings on the amended plan (III 21-65, 100-112, 120-212) the court approved the amended plan with the two compromises in it (III 250-252) and again overruled the objections to the compromises. (III 263-264)

It is important to note the district court found (III 373) that if the Merrill-Stevens and Caplan mortgage claims were *disallowed in toto* the debtor would remain insolvent and the stockholders would still have no equity. This finding is clearly supported by the evidence as we will show under the next point.

Dissenting stockholders of an insolvent company should not be permitted to impede Reorganization by insisting upon costly and protracted litigation of claims unless they will bear the costs thereof. *In re John H. Woodbury Dermatological Institute,* 191 Fed. 819 (2d Cir. 1911); *In re Ben L. Berwald Shoe Co.,* (N.D. Tex.) 1 F.2d 494 (rev'd on other grounds 10 F.2d 275, cert. den. 271 U.S. 671). Nowhere in the record do the stockholders propose to bear such costs but on the contrary insist that the debtor do so, necessarily at the expense of the equity of the creditors.

It would be highly inequitable to permit the stockholders to delay the final consummation of the plan of reorganization while the trustee gambles on the outcome of

time consuming and expensive litigation over these claims. The provisions in the plan for these claims should therefore be upheld.

4. THE DISTRICT COURT'S FINDING OF INSOLVENCY WAS CLEARLY CORRECT AND ITS DETERMINATION OF REORGANIZATION VALUE BASED ON SUBSTANTIAL AND COMPETENT EVIDENCE.

The issue is whether or not the debtor is insolvent and not whether the lower court accurately computed its going concern value. A precise finding of value is not necessary to eliminate the stockholders. *Institutional Investors* v. *Chicago, M. St. P. & P.*, 318 U.S. 523, 539.

An estimate of going concern value, as distinguished from mathematical certitude, is all that can be made. *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 512, 526.

On appellate review, this issue is whether the finding of insolvency by the trial court is *clearly erroneous*, and whether there was substantial and adequate support in the evidence for the finding. *Spitzer* v. *Stichman*, 278 F.2d 402, 410 (2d Cir. 1960). *Trinity Building Corp. Pref. Stockholders* v. *O'Connell*, 155 F.2d 327, 329 (2d Cir. 1946). Great credence is to be given to the reorganization judge's long familiarity with the debtor and his evaluation of the witnesses. *Meyer* v. *Dolan*, 145 F.2d 880, 881-882 (2d Cir. 1944). The appellate court should not try to resolve disputed evidence on this subject. *Trinity Building Corp. Pref. Stockholders* v. *O'Connell*, supra.

a. There is an abundance of competent evidence to support the district court's findings of insolvency.

The first valuation hearings were held before the district judge in the early part of 1962 when the plans of reorganization proposed at that time were being considered. They consumed several days, with many witnesses and numerous exhibits. (II 42-310, 310.52-356)

The book value of the debtor's assets as of May 31, 1962, was shown to be $1,887,185.77 (II 387.1-387.2) as against claims arising prior to the reorganization proceedings of $5,477,370.05. (II 288)

The trustee first presented evidence as to the actual fair value of the debtor's assets, as distinguished from their book value as shown above. A special master had taken evidence and reported on the value of the vessels (II 10-22) and other evidence was received during the valuation proceedings as to the actual or fair value of the remaining assets. (II 45-50, 221, 222, 223) The result of this evidence was to raise the value of the assets to $2,238,387.62 and to increase the net value of the debtor's assets to $1,978,481.73 and the court so found in its order. (II 387.2)

This net appraised value of the debtor's assets is material because it is *lower* than the going concern value of the trustee ($2,031,000) and of the court ($2,780,000). The significance is that we have a business dependent for its value not on the inherent value of its assets but primarily on maintaining a high level of earnings. It is necessary, therefore, that its future earnings be estimated as accurately as possible based on present use of the existing assets and that consideration be given to unfavorable as well as favorable economic factors in the future.

As a basis for estimating future earnings to determine going concern value the trustee presented a series of ex-

hibits which included all balance sheets and earnings statements from the beginning of the trusteeship through May 31, 1962 (II 198-220, 355, 356), statements showing the historical build up of the book value including trustee's costs of additions covering all tangible assets (II 221-222), an analysis of the vessel valuation evidence (II 223), projections of estimated income, expenses and earnings for future years through 1965. (II 224-226, 350-354) Other exhibits not directly material to the valuation issues were introduced to show the effect of and the feasibility of the internal plan of reorganization. (II 288-299, 348, 349) These exhibits gave the court and interested parties *all material information available from the records of the debtor* with respect to its assets, liabilities and earnings from the beginning of the trusteeship through May 31, 1962.

The trustee analyzed the evidence and computed a going concern value of $2,031,403.72. (II 227-229)[20]

The trustee presented a valuation expert, Dr. William G. Heuson, Professor of Finance at the University of Miami, who took the trustee's estimates of future earnings and computed the going concern value at $1,607,692. (II 125) He admitted on cross-examination that his value could go as high as $1,800,000. (II 160) Dr. Heuson testified at length in support of his method of converting the estimated future earnings into value. (II 124-176) Basically he assumed earnings to be 13% of value or, expressed as the trustee did, he multiplied estimated earnings by about 7.7 to arrive at value.

Petitioner presented a witness, Dr. Albert B. Morgan, in an attempt to justify the use of projections of earnings based on expectation of continually increasing revenues, untried practices and general economic conditions in

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[20]Testimony explaining this analysis is at II 43-57.

Puerto Rico, and without regard for the trustee's evidence that unfavorable factors were on the horizon. This witness went overboard with estimated future earnings averaging $327,500 after taxes (56% higher than the trustee's) based on speculative assumptions (II 240-249) and he multiplied this estimate by a price-earnings ratio of 13.8 times. (II 250) He obtained this high ratio by averaging those of ten large well established firms that were not comparable to TMT. He came up with a value of $4,519,500 which the court properly refused to consider. His figure is still considerably short of the $5,400,000 in claims that must be satisfied before the stockholders have any equity, and his evidence was fully rebutted by Dr. Heuson, the trustee's witness. (II 300-310)

The court considered all of the evidence and came up with its own finding of going concern value: $2,780,000. (II 387.5-387.6) This finding was based on capitalization at 10% of the estimated 1962 earnings, the highest under the trusteeship.

When the matter was considered again in 1965, further testimony was taken to up-date the 1962 valuation evidence. (II 120-211, 75-83) The new evidence disclosed that 1962 had been the peak year of earnings and that they had fluctuated as follows:

Year	Earnings
1958	$229,000
1959	207,000
1960	210,000
1961	373,000
1962	524,000
1963	403,000
1964	200,000

(II 77)

The record contains a full explanation of numerous unfavorable factors that have contributed to the decline in TMT earnings during recent years.[21] The trustee's general manager had predicted in 1962 that increasing competition was a serious factor (II 907) as was the cost of having to replace some time in the near future the old World War II LST's that the debtor was still using. (II 910) His testimony in 1965 described "rate wars" in Washington before the Federal Maritime Commission which were resulting in rate cutting and reduction in revenue. (III 295-296, 126-140, 79-83)

For example, the rate had to be reduced on automobiles (a major item of traffic for TMT), to meet the competition, from 34¢ to 31¢ per cubic foot, or an average of $14.00 per car. This caused a revenue reduction of $100,000 on the 7,200 automobiles transported in 1964. (III 128) The rate reductions caused the profit per voyage to drop from $5,300 to $2,000 between 1963 and 1964 (III 130-131), while operating expenses increased.

The 1965 findings of insolvency are as follows:

"The Solvency of the Debtor

The court required, by order entered January 5, 1965, further evidence on this subject limited to happenings subsequent to the 1962 valuation hearings. The court had found the debtor insolvent at that time, and it appears from subsequent events that the debtor is more insolvent now than it was in 1962 when earnings had reached a peak. As predicted by the trustee, the level of earnings reached that year of $524,000 did not last. They dropped to $403,000 in 1963 and to $200,000 in 1964. This was caused by several unfavorable factors the principal of which was increased com-

[21]They were $341,000 in 1965 and only $28,000 in 1966, although these figures are not in the record before the court.

petition from large steamship lines serving Puerto Rico. It appears from the evidence that these competitors in the latter part of 1962 began rate-cutting practices deliberately designed to take business from TMT. They have been successful to an extent requiring TMT to reduce its rates on automobiles and other heavy volume traffic, thus materially reducing its margin of profit on each trip. This smaller margin of profit has caused a decline in net earnings in spite of a greater volume of traffic obtained by the increase of the trailership fleet from three to five vessels since 1962. Increases in costs of operation have also contributed to the decline in earnings.

The SEC and the Stockholders Committee, insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee nor the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances of operation would be speculative and unreliable. The trustee has operated the business successfully for more than seven years and the past earnings recorded under the trusteeship furnish the most reliable basis upon which to measure future earnings for going concern value purposes in this proceeding.

The court in 1962 found the going concern value to be $2,780,000 based upon retention of the high level of earnings during the first half of that year. It is apparent now that this value was too high and would be much lower based on any average of the earnings recorded under the trusteeship.

Another factor which depresses the value of the debtor is the requirement that the government non-

tax claims must be paid in full in cash. This will reduce the equity of the new owners of the debtor by approximately $500,000.

It is therefore the opinion of the court that the debtor remains insolvent, and the court reaffirms its former finding of insolvency and its decision that under the strict priority rule stockholders have no equity in the reorganized company and are entitled to no further participation in these proceedings." (III 266-268)

These findings are fully sustained by the record herein.

b. The district court properly refused to consider speculative estimates of future earnings of the debtor.

Opposing counsel criticise the district court's finding of insolvency based on evidence of the trustee's earnings and insist that the court should have made speculative estimates of what the earnings after reorganization might be *under different operating conditions.*

Petitioner, for example, insisted that since new vessels were required the value of the debtor should include a "projection of the increased net earnings that could be achieved by the purchase of such ships. . . ." (II 1080) However, testimony on behalf of the trustee showed that such an estimate could not be made (III 293-294), that it was not known how much new vessels would cost or how they would be financed and that the trustee considered these to be matters that must be left for determination by the new owners of the company after reorganization. (III 144-151, 294-295)

The SEC argues that the district court refused to consider the *growth* of the debtor's business (brief, p. 53)

but *growth* in terms of increased volume is not the factor involved. The factor is *earnings* which the evidence shows have been declining in spite of increased volume because of cost and competition factors.

The SEC urges that the law "requires recognition of contemplated changes in operations and acquisitions." (brief, p. 54) The law does not require this; it requires contemplation of future *earnings* and those of TMT have been declining. The fact that the district court may have refused to consider future earnings in this case is immaterial because if it had, the going concern value would have been much *less* than the value found of $2,780,000. The SEC position is also unsound because the trustee was not at liberty to "contemplate changes." They would be up to the new owners *after* reorganization.

The arguments of opposing counsel on this point overlook the main issue—that of insolvency. The debtor will not be made more solvent *now* by speculating on possible increased earnings in the distant future under changed conditions of operation and ownership. The new owners must take the risks of necessary expansion and will be entitled to the profits, if any.

c. The cash bids for the assets of the debtor do not indicate a higher going concern value than that found by the district court.

While the brief for the SEC does not mention this point, the Petitioner insists throughout its argument on the valuation question that cash bids exceeding the going concern value found by the court indicated that the court's finding was too low. This argument is entirely misleading because Petitioner neglects to inform the court that these bids were for *all* the assets "including all current

and fixed assets of every kind and nature" (III 750) and *not* assume any of the trustee's liabilities.

The current liabilities were $220,000 on May 31, 1962, (II 348) shortly before the last firm bid of $2,515,000 was received on July 3, 1962 (II 750), prior to the approval by the district court on July 11, 1962, of the two plans under consideration. It was this $2,515,000 bid that was approved and became a part of the Cash Plan that the creditors voted on at the same time they voted on the Internal Plan.

In order to compare the cash offer with the insolvency finding of value, it is necessary to subtract the current liabilities because they would have to be paid out of the cash bid, reducing the net amount available for distribution to creditors to far below the $2,780,000 going concern value as found by the court.

A cash bid of $2,800,000 (II 865-866) was not received until December 17, 1962, long after the creditors had soundly rejected the Cash Plan sent to them for consideration and had overwhelmingly accepted the Internal Plan that gave them ownership of the company. Only 13.5% of the unsecured creditors and 28.4% of the lien claimants had favored the Cash Plan. (II 388)

Petitioner says on page 19 of its brief that this $2,800,000 bid exceeded the court's value of the debtor. This is misleading because it was not a net offer. Petitioner and everyone else involved knew that these cash offers were not attractive to the creditors. They were subject to other infirmities such as the fact that the proposed compromises of the Caplan and Merrill-Stevens claims were *not* included in the Cash Plan (II 373) and its acceptance would have involved extensive litigation over

those claims of uncertain outcome, and the common creditors could have wound up with almost nothing.[22] The Creditors Committee had reported that it would not recommend a cash plan that did not provide for a maximum payment of at least 50¢ on the dollar for the unsecured creditors. (II 652)

Concluding our discussion of the insolvency of the debtor, we point out that the extent of the insolvency is actually much greater than the difference between the $5,400,000 in claims and the $2,780,000 found by the court to be the going concern value. The principal total of the claims must be increased by interest on them before stockholders have any equity. It has been held that the strict priority rule of this court requires that if the debtor in a Chapter X proceeding is *solvent*, creditors must be compensated in full with interest before there is any surplus for stockholders. *In re Inland Gas Corp.*, 241 F.2d 374, 381 (6th Cir. 1957). *Spitzer* v. *Stichman*, 278 F.2d 402, 405 (2d Cir. 1960). The interest on creditors claims since the beginning of these proceedings in 1957 would amount to several million dollars.

It is apparent that this debtor is hopelessly insolvent and that the findings of the district court to that effect are well supported by the evidence.

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[22]The total of all claims superior in class and priority to unsecured creditors totaled more than $2,200,000. (II 288)

5. STOCKHOLDERS ARE NOT ENTITLED TO PARTICIPATE IN THE REORGANIZED COMPANY ON A PARITY WITH COMMON CREDITORS.

The complete findings of the district court on this subject are found in the body of the initial order approving the plan (II 370-382) and are as follows:

> Another proposal, however, was that certain stockholders should be permitted to participate as unsecured creditors upon filing and proving up claims based on rescission of their purchase of the stock. There is nothing in the record of these proceedings to indicate that any stockholders have any claims against the debtor that would permit them to recover on such a theory, which is intended to cover stockholders *who acquired their stock on the open market* and not from the debtor. No such claims had theretofore been filed and the time for filing claims expired several years ago. The proposal would arbitrarily set aside 25% of the common stock under the Internal Plan for the benefit of stockholders who could prove a right to rescind. The equity of the unsecured creditors cannot be diluted in this manner.
>
> The Stockholders' Committee also filed a PROOF OF CLAIM FOR RESCISSION on behalf of unnamed stockholders who purchased stock of the debtor on the open market. The facts stated in this document are insufficient to show that any stockholders as a class or individually have valid claims against the debtor. Furthermore, the claim is filed too late and is vague and indefinite as to who the claimants are and the extent and amount of their claims. It is too nebulous to delay reorganization at this stage.
>
> Likewise, the claim filed by Irma S. Mason, wife of a member of the Stockholders' Committee, seeking to rescind her purchases of TMT stock on the open mar-

ket is without merit for the same reasons. It shows that her damages, if any, are recoverable against others than the debtor. (II 379-380)

The equity and correctness in the finding of the district court are reflected by the affirmance of the court of appeal:

> No valid reason or excuse is given for the delay from July 1960 until June 1962. To allow the filing of additional claims of an unknown number of stockholders, which by their nature might have required years to litigate and which might have delayed indefinitely the formulation of any plan of reorganization would have been extremely prejudicial to the creditors. (364 F.2d at p. 940)

a. The alleged stockholders' claims were not timely filed.

The briefs of the Petitioner and the SEC proceed to a discussion of the errors of the lower courts on an invalid assumption, i.e., that the alleged rescission claims do, in fact, exist. The Petitioner gives the impression that a large body of dissident stockholders have been prohibited from presenting their claims via the Petitioner by the actions of the district court. After all these years, the committee representing stockholders has been able to get only one stockholder to file a claim for rescission, Irma S. Mason, who is *one of the attorneys of record for Petitioner!* The actions of Petitioner in waiting until June, 1962, to file a rescission claim can only be explained by a decision to elect the status of a shareholder after it became apparent that the debtor was insolvent and that stockholders were to be excluded from participation in the reorganized company. Such dilatory action has contributed to unnecessary delay in the consummation of the plan of reorganization.

The Petitioner would give the impression that their rescission claims were not timely presented due to a lack of

knowledge of the facts upon which they were grounded and that when such facts were known they were prohibited from pressing such claims. This position is not sustained by the record. Petitioner knew of some of the facts underlying the claim for rescission as early as 1958 but elected not to pursue that course of action until 1962.[23]

Petitioner argues that its Petition for Leave to File a Statement of Position filed in April, 1963, was tendered to the court in March, 1961, but the court would not accept it at that time.[24] The record reveals nothing to substantiate the alleged tender of any statement of position concerning rescission claims by the protective committee. An order was entered on April 26, 1961, denying a petition by Petitioner for leave to file a statement of position. The order does not indicate the nature of the petition. (II 861). The petition referred to was not filed until April 16, 1963 (II 962), is dated March 21, 1961, and clearly states that the statement of position which is desired to be filed pertains ". . . to certain matters referred by the Court to the Special Master and generally with respect to the validity and status of the claims of Arthur Shaffer and M. James Spitzer as trustees of a certain alleged mortgage, and of the beneficiaries of said alleged mortgage and with respect to the claims of Merrill-Stevens Drydock & Repair Company, and of certain other claimants."

There was nothing in the petition to indicate that it pertained to rescission claims. The only things that had been referred to the Special Master were the mortgage and the lien claims against the vessels of the debtor. It is true that the record shows the filing on April 15, 1963, of a

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[23]See letter dated November 10, 1958, from Petitioner's counsel to the district judge. (I 128-134)

[24]Petitioner's Brief p. 14, footnote 17.

Statement of Position by Petitioner (II 1037) which is *dated* March 21, 1961, and which makes general reference to the possibility of rescission claims. (II 1039) But there is nothing to indicate that the issue was ever brought to the attention of the court or any interested party in March of 1961 as Petitioner contends. In any event the matter lay dormant in the bosom of Petitioner until a year later and no explanation is furnished for the failure to file any stockholder's rescission claim as soon as its existence was known.

This Statement of Position, dated March 21, 1961, and filed April 15, 1963, expressly recognizes that the bar date of April 14, 1958, for filing claims had long passed when in paragraph 9 a request was made to extend the time for filing claims. (II 1039)

The alleged rescission claims (II 358-368) were not filed until about June 19, 1962, which was *after* all the hearings had been held to consider the two plans of reorganization and only three weeks before the court entered its order approving the plans and refusing to consider the alleged rescission claims. (II 370-382) The first appearance on the record of anything pertaining to rescission claims was in a pleading filed by Petitioner on March 20, 1962. (II 1074) We submit that no valid reason for the delay is shown.

The committee now urges, however, that "It would be absurd to compel the committee to comply at this stage with the formal requisite of a proof of claim that it identify each stockholder by name, address and certificate number for the purposes of a securities law claim any more than for a claim to a piece of the equity."[25] This statement is confusing in view of the Petitioner's request to remove the 1958 bar date and considering the practical necessity under its

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[25]Petitioner's Brief, p. 58.

own theory of rescission for individual stockholders to make of record the circumstances under which they purchased their stocks, and the price paid, etc.

Under subpoint 2 of its Point III on appeal, Petitioner claims it was error for the court to determine in the absence of a hearing that the alleged stockholders' claims were filed too late. We submit, however, that the records before the court below showed the appearances of Petitioner from 1958 until its proof of claim in 1962, and that at no time did it, prior to the spring of 1962, urge the rescission claims upon the court, nor was any excuse offered for the delay in raising the issue until 1962. In fact, when in the spring of 1962 Petitioner finally filed its suggestions which first set forth the rescission theory, it evidenced its indecision to elect to pursue either the posture of creditor or shareholder by stating, "the entire consideration of independent stockholders' rescission claims will of course become unnecessary if an adequate equity for them is otherwise recognized." (II 1086) It is on this record of equivocation by Petitioner that the district judge determined that the time had passed to file a tort claim for rescission.

To use a trite but appropriate phrase, Petitioner is attempting to have its cake and eat it too. It cannot maintain the posture of a stockholder and then shift when the position suits to the posture of a defrauded creditor. Such action makes a mockery of the need for a bar date designed to bring an end to the filing of claims. The record before the court and the circumstances pointed out above were clearly sufficient to sustain the dismissal of the alleged rescission claims without a hearing.

b. The alleged stockholders' claims are factually insufficient to warrant their consideration.

The stockholders' alleged claims are claims for rescission and absent the citation of SEC Rule 10(b)(5) and the various quotations from cases thereunder in the SEC brief, a short answer to the issue would be that the defrauded buyer's right to rescind his purchase exists only as against the person who sold the securities to him. This obvious proposition follows from the inherent nature of the rescission remedy, i.e., the restoration of the party to the *status quo* which existed prior to the fraud. The proofs of claim filed herein (II 358-368) seek to rescind open market purchases of TMT shares as against the debtor which never received directly or indirectly the consideration paid on the open market, and which itself was defrauded in parting with those shares through the wrongdoing of the true culprits. The stockholders' claims for rescission as against TMT are illogical on their face and the question arises whether Rule 10(b)(5) incorporates this lack of logic in the law of interstate securities frauds. No one doubts that Rule 10(b)(5) has relaxed the old common law standards of privity or that the common law itself has recently relaxed those standards, but the consequences of this relaxation do not include the results now urged here.

This relaxation of the necessity for privity is intended only to enable the injured person to reach the guilty beneficiary for recovery of his damages. TMT received *no benefit* from money paid on the open market by purchasers of its shares. The rule of law recognizing the right of a defrauded buyer to recover his purchase price has been stated in 78 C.J.S., Sales, Sec. 490, as follows:

> The right of a buyer to recover sums paid under a rescinded contract does not rest on agreement but rather is grounded on the theory that the seller, having

> obtained money under a contract made void by rescission is unjustly enriched at the buyer's expense and as a consequence should be subjected to a legal duty to restore that which has been improperly gained.
> *Kavli* v. *Leifman*, 292 N.W. 210, 207 Minn. 549.

TMT has not been enriched by the alleged fraud perpetrated on the open market buyers of its stock. Therefore, recovery against it in a rescission action cannot be had. TMT has itself been the victim of the alleged fraudulent transfers of its stock by various persons.

We agree with the part of the SEC argument on pages 64-65 of its brief that privity is not required for rescission recovery by a defrauded stock purchaser.

However the relaxation of privity is designed to prevent the escape from liability of any party to a fraudulent scheme, no matter how he had technically insulated himself from the ultimate fraudulent transaction with the innocent buyer, not to create causes of action against persons who themselves were duped by the fraudulent scheme. None of the persons named in the two alleged rescission claims (II 358-368) as having improperly acquired TMT stock which they dumped on the market were officers or directors of TMT.

c. If rescission claims were allowed, they would necessarily be subordinate to the claims of creditors.

Regardless of the merits of alleged stockholder claims against TMT, the fact remains that *innocent creditors* entered relationship with TMT on the basis of its alleged over-stated balance sheets with the expectation of being able to recover fully out of its assets before any distributions were made to shareholders, and the shareholders entered into their relationships by buying on the open market

with the realization that if insolvency should occur and if TMT assets should prove to be worth less than the amount at which they were carried on the balance sheet, the creditors whose claims were reflected on the balance sheet as liabilities would be entitled to a senior position in reorganization. These expectations and these consequences are basic to the functioning of our industrial and financial economy and every consideration of prudence and fairness dictates that the expected rights, preferences and disabilities of the parties be adhered to in reorganization proceedings.

Rescission claims by stockholders traditionally have been subordinate to creditors' claims in bankruptcy proceedings:

> The law of the domicile of this bankrupt corporation in which appellant is a stockholder, and the great weight of authority, are that, given a corporation insolvent and unpaid subscriptions, corporate fraud inducing the subscriptions affords no stockholder a defense to collection, or ground for rescission, or basis for trust or lien, to the prejudice of corporate creditors. A fortiori, nor in respect to stock subscriptions paid. (Citing other cases)
>
> * * * * * * * *
>
> However ignorant appellant of corporate insolvency and transactions, he knew the corporation was engaged in business, and might, as it did, incur debts. Hence he was charged with notice and knowledge of corporate status and acts, so far as creditors were concerned. That no creditors knew he was a stockholder is immaterial. Credit is given to corporations, with little or no knowledge of names of stockholders, but with confidence that, whoever they are, their rights in and to corporate property are subordinate to the rights of creditors.
>
> *In re Irving Whitehouse Co.*, 293 Fed. 287 (9th Cir. 1923)

Petitioner attempts to set aside this traditional bankruptcy principle by an appeal to the principles in *Oppenheimer* v. *Harriman National Bank & Trust Co.*, 301 U.S. 206, a case arising under the National Bank Act. (12 U.S.C., Sec. 21 et seq.) A review of the National Bank Act clearly distinguishes it from the Bankruptcy Act. The Bank Act provides "the comptroller (of currency) shall make a ratable dividend of the money so paid over to him by (a) receiver on all such claims as may have been provided to his satisfaction or adjudication in a court of competent jurisdiction." (12 U.S.C., Sec. 194) Distribution is not entrusted to a court of equity empowered to determine the order of distribution, but to an administrative official bound by a statute which directs ratable distribution on *all claims*. The unique nature of national bank proceedings was noted by this court in *Cook County National Bank* v. *United States*, 107 U.S. 445, where it was faced with the question as to whether the United States' statutory priority of payments for debts due to it applied in a case of an insolvent national bank. The court stated that:

> . . . the act authorizing the formation of national banks . . . constituting by itself a complete system for the establishment and government of national banks. . . . Everything essential to the formation of the banks, the issue, security, and redemption of their notes, the winding up of the institutions, and the distribution of their effects, are fully provided for, as in a separate code by itself, *neither limited nor enlarged by other statutory provisions with respect to the settlement of demands against insolvents or their estates.* (107 U.S. at 448) (Emphasis supplied)

This court held that R.S. 5236 (12 U.S.C., Sec. 194) "provides for the distribution of the entire assets of the bank, *giving no preference to any claim* except to monies to reimburse the United States for advances in redeeming notes." (*Id.* at 450) (Emphasis supplied)

The proposition propounded by the *Cook County National Bank* case that the statutes with respect to national banks require ratable distribution without regard to other statutory priorities or other equities has been consistently adhered to.

In *Texas & Pacific Railway Co.* v. *Pottorff,* 291 U.S. 245, 255, Justice Brandeis stated in the course of considering whether national banks had power to pledge their assets to secure a private deposit, that to permit such pledge "would be inconsistent with many provisions of the National Bank Act which are designed to insure, in the case of disaster, uniformity in the treatment of depositors and a ratable distribution of assets."

Other than cases controlled by the National Bank Act, it is uniformly held that stockholder rescission claims, even when a corporate fraud exists, are subordinate to the rights of creditors. In cases involving insolvent state banks (the rigidity of the National Bank Act being inapplicable), stockholders who have been induced to purchase stock by false representations are subordinate to the rights of depositors and other innocent general creditors. See, e.g., *Green* v. *Stone,* 205 Ala. 381, 87 So. 862 (1921); *Davis* v. *Burns,* 173 S.W. 476 (C. App. Tex. 1915); *Burleson* v. *Davis,* 141 S.W. 559 (C. App. Tex. 1911).

The SEC brief states "under both statutes (Bankruptcy Act and National Bank Act) the ultimate standard is one of an equitable distribution of assets." A review of the equities in this cause indicates that they lie with the Respondent and the creditors and not with the Petitioner and the stockholders.

It is inequitable to allow parity treatment of stockholders' rescission claims because the claimants bargained for equity-type profits and assumed equity-type risks. In

contrast, orthodox creditors dealt with the corporation with the expectation that they would have a senior position as against its assets to that of stockholders. They bargained for debt-type profits and certainty of payment.

This basic difference exists even where a corporate management has been guilty of the grossest fraud. When (as here) both creditors and stock purchasers have been defrauded, the equities obviously favor the former over the latter. A defrauded stock purchaser always has an option to ratify his purchase and thus is able to straddle the future prospects of the manipulated company. If things go well, he shall be a stockholder, and if things go poorly, he shall be a creditor. This straddle is inequitable at least vis-a-vis unsatisfied creditors.

The history of the Stockholders Committee in this proceeding shows the most flagrant straddling. Initially it claimed that the debtor might be solvent but at least as early as July 1, 1960, when the Report of Investigation was filed, it had knowledge that the market had been flooded with stock that should not have been resold. Thereafter, for nearly 2 years the Committee failed to file a single rescission claim, nor did any stockholder other than Mrs. Mason who, of course, is estopped to assert the timeliness of her claim because she is of counsel here. The SEC brief on page 69 suggests that the court at this late date should fix a time for the filing of claims by stockholders. But there is nothing to indicate that any would take advantage of the invitation.

d. The rescission claim on behalf of all "non-management" stockholders cannot be recognized as a class claim.

Counsel for Petitioner filed this claim based on allegations "made on information and belief". (II 363-368) It as-

serts that all "non-management stockholders" have "a right to rescind the purchase" of TMT stock made by them on the open market.

The claim of each such stockholder would be in *tort* and would be unliquidated as to amount. Each would depend on the time and circumstances of purchase, the consideration paid and lost on the transaction, and whether the stock could be traced as having come into the claimant's hands wrongfully. This is not the kind of class action permitted by Rule 23 of the Federal Rules of Civil Procedure. *Speed* v. *Transamerica Corporation*, 5 F.R.D. 56 (D.C. Del. 1945); *Joseph* v. *Farnsworth Radio and Television Corporation*, 99 F. Supp. 701 (S.D. N.Y. 1951); *Gilbert* v. *Clark*, 13 F.R.D. 498 (D. Mass. 1952); *Farmers Co-op Co.* v. *Socony Vacuum Oil Co.*, 133 F.2d 101 (8th Cir. 1942).

Nor can we find any provision in the Bankruptcy Act for the filing of a class claim on behalf of unknown tort claimants in unknown, unliquidated amounts. Section 209 authorizes any creditor or stockholder to be represented by a committee but this does not permit class claims for unknowns. Section 210 requires the filing of the names and addresses of all creditors or stockholders represented by an attorney together with the nature and *amount* claimed. Section 211(4) requires a statement under oath showing the amounts of claims represented by a committee.

Petitioner has been approved by the district court as a stockholders committee but has neither sought nor obtained approval to represent stockholders as *creditors*.

We submit that there is no basis for giving any recognition or effect to this class claim and that it was properly refused consideration by the district court.

6. THE DISCHARGE OF THE STOCKHOLDERS COMMITTEE WAS PROPER.

Chapter X of the Bankruptcy Act clearly contemplates that, upon confirmation, a plan of reorganization shall be binding upon all parties and interests, including stockholders (Section 224 (1)), and that any class which does not participate under the plan should likewise not participate in further proceedings. Section 247 was amended in 1962 to make it very clear that upon confirmation of a plan from which no appeal is pending such classes need not even be given notice of hearings on applications for allowances. As explained in House Report No. 1208, 87th Cong. 1st Sess. (1961), "Once a plan has been confirmed, eliminating participation on the part of any class of creditors or stockholders, notice as to applications for allowances is purely academic and, in the interests of economy, should be eliminated. The typical situation, of course, is one in which a corporation is found to be insolvent and no provision for stockholder participation is contained in the confirmed plan."

The Stockholders Committee was discharged primarily because it had been determined that the debtor was insolvent and the services of the Stockholders Committee were no longer useful. (III 387-389) The rights of the stockholders have not been prejudiced because a modifying order was entered authorizing the Stockholders Committee to prosecute its appeals from the orders of the district court. (III 411-412)

CONCLUSION

All of the issues involved require an evaluation of the facts and circumstances connected with the affairs of this debtor. No good reason has been shown for sending this case back for further consideration of the facts in view of the thorough hearings held in the district court prior to the 1962 and 1965 orders approving the plan. There is no indication that further review would result in any different result. The plan of reorganization is basically fair and equitable to the creditors who desire to retain the services of the trustee, who have accepted the compromises of the disputed claims and who are entitled to full priority over stockholders since the debtor is insolvent.

The purpose of Chapter X of the Bankruptcy Act is to look to the future of the debtor and not to the past. The debtor should not be burdened with the expense and delay of trying to punish all who may have caused the decline and fall of TMT where the crusade might be fruitless and there is urgent need for the termination of the trusteeship.

TMT is being seriously harmed by the long delay caused by the efforts to block the reorganization desired by the real parties in interest who are the creditors. The old World War II LSTs which are the life blood of the company were built to be expendable and are inefficient. The major financing required to replace them cannot be had while the trusteeship exists; the Department of Commerce has approved as feasible the guaranty of a large loan for this purpose, but will not consider it as long as the plan of reorganization is under attack in the courts.

It is necessary, as the district court and the court of appeals observed, for the reorganization proceedings to be concluded without further delay; otherwise the company

may not survive and the fruits of a successful trusteeship benefit no one.

We respectfully submit that the orders and opinions of the lower courts should be affirmed.

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Dated: October 19, 1967

APPENDIX

Inaccuracies in the Statement of the Case, Brief for the Petitioner

1. Page 5—The debtor is "essentially sound and profit making."

Misleading because the debtor was never a sound operation under the pre-reorganization leadership of Eric Rath. Its operating loss in 1956 was more that $800,000 and it lost even more in 1957 before these proceedings began in June of that year. (Trustee's Report of Investigation, I 260, 270-272)

2. Pages 5 & 13—References to the trustee having received from the reorganized company "stock options firmly promised or transparently understood" (p. 5) and "formal assurance of substantial stock options". (p. 13)

These statements are wholly inaccurate because none of the various plans of reorganization approved in these proceedings has authorized, expressly or by implication, the issuance of stock options to the trustee or to anyone else.

3. References throughout the brief to charges of *fraud* against Merrill-Stevens are entirely untrue. There are no *facts* anywhere in the record to indicate that Merrill-Stevens did anything fraudulent. The best evidence of this is contained in the complete specifications filed by Petitioner detailing its objections to the Merrill-Stevens claim. (II 1042-1072.4) This document, 36 pages of unsworn statements by counsel, contains no facts pertaining to any alleged *fraudulent* transaction. All of the objections to the claim pertain to the work performed under contract on the vessels of the debtor and to an alleged contract to purchase

certain common stock of the debtor; all pertain to charges involving alleged torts or contract violations. This is made clear by the concluding paragraph of the specifications which states:

In conclusion, we do not have to prove tort claims against Merrill-Stevens. Merrill-Stevens has to prove contract claims against the debtor. The burden is squarely on them. (II 1072.4) The charges of fraud against Merrill-Stevens constitute improper use of the word by Petitioner's counsel throughout these proceedings, including unwarranted assumptions to that effect contained in the statement of Questions Presented.

4. Page 5—The statement that *control* of the debtor under the plan of reorganization "went to the trustee along with one or another of the insider creditors" who had participated in frauds.

This statement is misleading for the same reasons noticed at the beginning of our Statement of the Case with respect to a similar misrepresentation in the SEC brief.

5. Page 10—Characterizing the plan of reorganization as "control to Merrill-Stevens without investigation of fraud charges; priority to Shaffer-Spitzer without remedy for proven fraud."

This is inaccurate in every particular: control did not go to Merrill-Stevens; its claim was thoroughly investigated; there are no facts to sustain a charge of fraud against Merrill-Stevens as explained under No. 3 above; there was no *proven* fraud against Shaffer-Spitzer.

6. Page 13—Charges of "marketrigging" by Merrill-Stevens.

This characterization is entirely false. Merrill-Stevens never sold any TMT stock.

SUPREME COURT, U. S.

No. 38

OCT 20 1967

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF *TMT* TRAILER FERRY, INC.,

Petitioner,

v.

C. GORDON ANDERSON,

Trustee.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR ARTHUR H. SHAFFER AND M. JAMES SPITZER, TRUSTEES (CAPLAN MORTGAGEES)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF *TMT* TRAILER FERRY, INC.,

Petitioner,

v.

C. GORDON ANDERSON,

Trustee.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR ARTHUR H. SHAFFER AND M. JAMES SPITZER, TRUSTEES (CAPLAN MORTGAGEES)

The Scope of This Brief Is Limited to the Directly Affected Interests of the Caplan Mortgagees

Arthur H. Shaffer and M. James Spitzer as successor trustees to Alex Caplan, trustee under indenture of trust (herein referred to as Caplan mortgagees) were the holders of two first preferred ship mortgages on four vessels owned by the debtor, securing its note in the principal sum of $330,000 (I 31-34, 67-79, I 97-98, 173, 175, 464; II 419-430).*

* The Caplan mortgagees have adopted the same form of record references as are used by petitioner.

The Caplan mortgagees are respondents before this Court, although not named as such in the caption, having been parties to this reorganization proceeding virtually since its inception, the appellants in the first three of the five appeals decided by the Court of Appeals in the proceeding, and party participants in the subsequent two appeals, including at all stages below on the present appeal.

This brief is confined to the directly affected interests of the Caplan mortgagees, namely, the provision in the plan of reorganization dealing with their claim.

The Caplan mortgagees take no position on any of the other issues raised in the briefs of petitioner and The Securities and Exchange Commission (herein referred to as SEC). Without continually reiterating, it is respectfully requested that all references herein to such briefs be understood as intended only as referring to their treatment of the Caplan mortgage claim.

Statutes Involved

Bankruptcy Act Section 27 (11 U.S.C. § 50):[1]

> "Compromises.
>
> "The receiver or trustee may with the approval of the court compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

New York General Business Law § 374:[2]

> "Corporations prohibited from interposing defense of usury.

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[1] Section 102 (11 U.S.C. § 502) makes section 27 applicable to proceeding under Chapter X.

[2] Now § 5-521 of the New York General Obligations Law.

"1. No corporation shall hereafter interpose the defense of usury in any action. The term corporation, as used in this section, shall be construed to include all associations and joint-stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships."

Statement of the Case

No stay of consummation of the reorganization plan was obtained or even sought by petitioner or the SEC. The position of the Caplan mortgagees, alone among all parties to the reorganization proceeding, has in consequence been irreparably harmed

By order filed September 21, 1965,[3] the District Court amended the provision in the plan of reorganization for the Caplan mortgage claim so as to reduce the amount allowed from $280,500 payable in instalments to $250,000 payable upon consummation (SEC Br., p. 13) and continuing the provision allowing unpaid interest as an unsecured claim. The order directed that the Caplan mortgages be satisfied.

Pursuant to such direction, upon consummation of the plan the mortgages were satisfied and discharged of record. Thereupon the assets which had been subject to the lien of the mortgages were encumbered by a new lien in favor of the Florida National Bank of Jacksonville, as security for a loan of funds used in connection with the consummation of the plan (District Court orders, September 27, 1965).

The SEC moved in the Court of Appeals "only to stay the issuance of the new stock" to be issued under the plan of reorganization. It made no application to stay consummation of the other provisions of the plan.

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[3] The District Court orders referred to herein are printed as an Appendix to this brief.

Petitioner joined in the motion of the SEC.

The motion was denied by the Court of Appeals.

The Caplan mortgagees are therefore in a position in which their interests have been irretrievably altered and, alone among all parties to this proceeding, they cannot be restored to their former status.

Preliminary observation on the factual statements contained in the briefs of petitioner and the SEC

Petitioner's purported factual recital is a free-wheeling narration interspersed with inflammatory invectives, abrasive adjectives, and groundless claims of matters being "proven" contrary to the record. We protest strongly against such tactics as being aimed at creating an atmosphere unfairly prejudicial to the Caplan mortgagees, and as irrelevant to the issue of whether the record contains an adequate justification of the compromise provision in the reorganization plan. As is shown below, the attack on that provision is without merit.

It is significant that the brief of the SEC, as might be expected, does not associate itself with the excesses of petitioner. The Commission's statement, however, both as to the history of the proceeding and in respect of the Caplan mortgage claim is so truncated as to omit important indisputable facts and neglects the grossly inequitable treatment accorded that claim from the inception of the proceeding.

The nature of the Caplan mortgage claim

The sections of the opposing briefs relating to the Caplan mortgage claim are devoted wholly to matters other than, and are signally silent upon, the nature of that claim and the consideration on which it rests. Such omission is not inadvertent. Although 10 years have elapsed since the inception of this proceeding-and there has been much litiga-

tion and investigation relating to the claim, neither brief at this late date contains any specifics as to its claimed infirmity or authority that would preclude its enforcement in whole or in part.

In 1956-1957, the debtor operated a fleet of barges towed by tugboats (I 256; II 395, 451, 466, 475; III 140, 144). To enhance its service, it undertook to have a partially completed naval vessel (TMT Carib Queen) converted into a self-propelled ocean-going trailer ship (III 203, 586). Financing was obtained, through the Mellon National Bank, Pittsburgh, Pennsylvania, as Trustee, secured by a ship mortgage insured by the United States Maritime Administration (I 32; II 427, 431, 439-440; 1009-1015, 1019-1035; III 345). By statute such insurance required a predetermination by the Maritime Administration that the operation of the vessel was "economically sound" (46 U.S.C. § 1274(c)).

In May 1957, shortly before the first instalment of principal and interest was due, the debtor required cash—which is the event that gave rise to the Caplan mortgage loan (I 31-32, 272; II 595).

On June 3, 1957, Alex Caplan, as trustee under an indenture for a group of plainly disclosed investors, advanced to the debtor the sum of $330,000, for which it issued the following: (a) a promissory note in that amount secured by two mortgages on three barges and a small vessel; the principal sum was payable January 3, 1958, without interest (and at 6% a year if paid after maturity); the note was convertible, at the option of Caplan, trustee, into shares of common stock of the debtor at the rate of 1 share for each $1.25 of principal amount; and (b) 49,500 shares of such stock (I 32; II 419-430; Dkt. No. 17,117 at pp. 23-53, 163-193). The debtor made numerous inducing representations, including one of solvency, and certified that the the borrowed funds were required "to make pay-

ment on account of a mortgage on the TMT CARIB QUEEN and for other payments" (I 31-33, Caplan Exhibits 2, 3).[4]

All loan documents were entered into with and by Caplan as trustee, and he alone in such fiduciary capacity had the right to collect payment and to pursue available remedies (I 31-34). The names and addresses of the beneficially interested parties were set forth, as required by statute, in the recorded mortgages (Dkt. 17,117 at pp. 24, 164-165; I 464, 174-178).

The $330,000 so advanced by Caplan, trustee, was disbursed on the debtor's instructions (I 32) as follows:

To Mellon National Bank to pay an instalment of interest and principal on the mortgage guaranteed by United States Maritime Administration	$227,314.16
To Mercantile National Bank, Dallas, Texas, to satisfy a preferred ship mortgage on TMT Carolina	51,457.07
To discharge libels against TMT Cuba ..	10,228.77
For recording Panamanian mortgage on TMT Cuba	2,000.00
To debtor	39,000.00
Total	$330,000.00

It will thus be seen that the Caplan mortgages, so harshly characterized by petitioner and the SEC, redounded to the extent of over two-thirds (⅔) of the fresh, new money invested, to the benefit of the United States Government by reducing its liability on its mortgage guarantee. And

[4] The exhibits referred to were included in the documents stipulated by petitioner to have been produced and identified in July, 1958 (31).

the largest part of the balance of the funds was used to clear liens on vessels of the debtor to which they would otherwise have been subject.

In 1958 the Caplan mortgagees voluntarily made available all evidence concerning the "validity" of their claim. Neither petitioner nor the SEC saw fit to exercise their right of interrogation.

Shortly after the involuntary reorganization petition was filed, an order was entered staying all action against the debtor (I 23-24).[5]

On November 13, 1957, Caplan, trustee, sought to vacate the stay in respect of his mortgages and permission to proceed with foreclosure (I 27, 25; II 419-430). The District Court denied the application, Caplan, trustee, appealed, and the Court of Appeals reversed, *Caplan* v. *Anderson,* 256 F. 2d 416, remanding:

> "* * * to afford appellant an immediate hearing and unless immediate and satisfactory provision is made for the protection and satisfaction of his debt, or a clear showing is made that his rights will not be affected by further delay, the stay of proceedings to foreclose his liens must be vacated and he must be permitted to proceed with foreclosure of his lien." (419)

At a hearing on "all matters which may properly come before the Court in accordance with [the] mandate", the District Court questioned the validity of the mortgages, stated that the issues should be tried, that there would be a reference to a Special Master to determine the amount, priority, and validity of the liens, and that an additional

---

[5] It cannot be emphasized strongly enough that the Caplan mortgagees had no connection of any kind, directly or indirectly or inspirationally with the filing of that petition (I 21). Their interests as mortgagees or stockholders were directly in conflict with and adversely affected by that petition.

10 days would be allowed for filing objections to claims (I 28-31).

Neither petitioner nor the SEC filed objections to the Caplan mortgage claim (I 28-31).

To forestall delay in obtaining the "immediate" relief to which the Court of Appeals had held the Caplan mortgagees to be entitled, they thereupon—on notice to all parties—took the deposition in Miami of their counsel, M. James Spitzer, who had handled the original transaction (I 31, 62-63). The express purpose of the deposition was "for use in evidence before the District Court" and "for the purpose of establishing by competent evidence the validity" of the mortgages (I 31, 62, 76-77). The reorganization trustee and major creditors were represented and cross-examined (I 31).

The SEC and petitioner defaulted in attending. Subsequently, petitioner stipulated that:

> "The witness responded to all questions propounded to him, including concerning the making of the loan evidenced by the note of $330,000 issued by TMT Trailer Ferry Inc., to Alex Caplan, the trustee, the mortgages given as security therefor, the amounts paid by Alex Caplan trustee therefor and concerning the preparation, execution, filing and recording of the documents all of which pertinent documents were produced and identified." (I 20, 31)

Petitioner's self-laudatory depiction of its heroic efforts to uncover the purported mystery of the Caplan mortgage claim is thus shown to be at variance with the record and its own stipulation. Years before petitioner and the SEC assertedly embarked on getting the facts, the Caplan mortgagees voluntarily invited them to do so. For their own reasons petitioner and the SEC declined. Despite their lack of interest, "all questions propounded" were answered and "all * * * pertinent documents" were placed in the record (I 31, 76).

Every aspect and facet of the Caplan mortgage claim—including much that is far afield—has been minutely scrutinized on the record. Probably no other subject comprises as large a part of the file in this proceeding.

The parol and testimonial evidence referred to in the immediately preceding section of this brief constitutes only a small portion of the record relating to the Caplan mortgage claim.

In 1959, a settlement of the claim had been incorporated in a plan of reorganization that was approved, accepted by creditors and confirmed (I 135-137, 181-185). When the reorganization trustee moved to vest title in the reorganized corporation, the SEC petitioned for an investigation pursuant to § 167 of the Bankruptcy Act on the ground that it might disclose the plan to be unfair in that it would turn the corporation over to persons against whose claims the trustee "may" have defenses and counterclaims (I 37-38, 41, 204, 206, 213-215, 233, 235, 247, 249-251, 302; III 219-224). Essentially, the SEC asserted that it had information that one Joseph Abrams controlled a "number of participants in the mortgage" (I 222-223). At the hearing a representative of the United States Department of Justice (representing substantial tax claims as well as non-tax claims of the United States in excess of $900,000) stated that "these rumors have persisted since 1957, and, so far as I am concerned, they haven't gone unattended". He further stated that:

> "At Your Honor's direction, representatives of the new group and Mr. Anderson, together with their accountants, came to Washington, and myself, with other Department of Justice attorneys, and anyone else who wanted to participate in this hearing, interrogated these men for the better part of a day.
>
> I told them at the outset of this hearing that they were going to be asked some embarrassing questions and

if they were not prepared to answer we had better close the hearing now. And, for Your Honor's information, they said they were prepared to answer and they did answer and I did not find throughout the hearing in any instance an inaccuracy in the information that they gave me.

They gave me written authority to have an audit made of the books and records, which I did. I had all the information appraised.

I did not find anything that indicated to me that further investigation would be warranted. I did not find a sufficient contact between the old management of the Corporation and the new group to indicate any control of the new group by the old group.

Moreover, I didn't find evidence of any causes of action against the old officers of the Corporation that would enhance the assets of this Corporation." (Minutes of Hearing, January 22, 1960, pp. 6-7)

Nevertheless, the SEC petition was consented to by all parties, with the Caplan mortgagees requesting the reorganization trustee and the SEC to "conduct any investigation that they see fit * * * with respect to everyone connected with the [Caplan] group * * * in any manner, shape, or form" (I 482). The Court was informed that all documents would be produced by the beneficiaries of the Caplan mortgage trust "merely upon advice from [counsel for the reorganization trustee] that he wishes to take depositions at any time or place" (I 482).

The trustee's investigation was conducted by deposition procedure, with notice and an opportunity for creditors, petitioner, and the SEC to be represented and to participate (II 582). The only exception was that the deposition of Abrams was conducted *ex parte* by the reorganization trustee and the SEC with no previous notice to the other parties; the transcript was subsequently made available.

On the taking of all other depositions petitioner, the SEC and most major creditors attended and cross-examined (I 258; II 582).

The examination continued from January 29 to May 4, 1960. Thirty-three (33) persons were examined, including all but one of the original and the present trust beneficiaries. The Caplan mortgagees never sought recourse by substantive or technical means to prevent full disclosure of whatever information was sought from them. The trustee in his report to the Court noted that all had given excellent cooperation and furnished all information requested (I 259-260).

They were interrogated not only about their interests in the Caplan mortgages, subsequent transfer or acquisition of such interests, as the case might have been, but also about prior dealings, if any, with the debtor, Abrams, Shaffer, and others, as well as with numerous unrelated corporations with which Abrams either had or was reputed to have had some connection. All but one fully responded to every inquiry. More than 2,200 pages of testimony were transcribed and filed with the District Court. Over 60 exhibits were introduced, including all documents previously identified during the 1958 deposition of M. James Spitzer, in addition to documents relating to transfers of beneficial interests in the trust including that of Bostwick-Westbury Corporation in which Abrams' children had an interest (I 277-278; II 601-602). All testimony was filed and made available to all interested parties (II 582-583).

There is no detail of the Caplan mortgage transaction, however trifling, that is not now in the record. The minimum that can be said is that in consequence of the investigation the District Court had before it everything that could be adduced by the cumulative efforts and the most probing questions that could be propounded by counsel for the reorganization trustee, petitioner, the SEC, and major creditors,—taking turns, *seriatim*.

Despite this mountain of material in the record, petitioner and the SEC are apparently dissatisfied with its adequacy, although failing to point out what additional information they believe they could adduce in the future that they failed to adduce previously.

It is respectfully submitted that rarely has a claim been more examined, scrutinized, pored over, and pondered on than that of the Caplan mortgagees. Moreover, there is nothing about it or even remotely connected with it that is not now in the record and that has not been considered by the District Court and all the parties to this proceeding.

The history of this proceeding is highlighted by a series of broken agreements made with the Caplan mortgagees, grossly prejudicing their position. What is now sought by petitioner and the SEC is an extension of the same inequitable treatment.

Before setting forth the details, it is pertinent to note that at no stage of the proceeding have the Caplan mortgagees sought to avoid meeting squarely any challenge to their claim and at no time have they initiated overtures to compromise. In each instance, when prepared and set to defend their position, they have been the ones who were requested to accept an adjustment.

Caplan, as trustee, duly filed a proof of claim within the prescribed time limit, clearly asserting that "the said mortgages constitute first preferred and superior liens on said vessels and they are subject and subordinate to no claims or liens" (I 27-28, 75-76). No one was uncertain of the position of the Caplan mortgagees (I 50-52, 446, 450, 454-455).

The first appeal by the Caplan mortgagees resulted, as above shown, in a remand to afford "immediate and satisfactory provision * * * for the protection and satisfaction of [the Caplan] debt or a clear showing * * * that [their] rights will not be affected by further delay * * *" 256 F. 2d

416, 419. Instead of granting such relief, the District Court entered an order which, *inter alia*, appointed a Special Master to take testimony on the validity, amount, and priority of the mortgages (I 34-35, 84-87). The Caplan mortgagees thereupon took a second appeal (I 341); the Court of Appeals ordered the appeal expedited and denied a stay of the proceedings before the Special Master without prejudice to renewal if not "promptly and expeditiously conducted and brought to a close." *Caplan* v. *Anderson*, 259 F. 2d 283, 284-285.

Immediately upon rendition of that decision, the reorganization trustee, with the explicit encouragement and express authorization of the District Court, initiated settlement negotiations with the Caplan mortgagees (II 372; I 35, 120, 300-301, 453-455). The trustee proposed a compromise consisting of Caplan withdrawing the then pending appeal, forebearing from foreclosure, and permitting the debtor to continue uninterrupted use of the encumbered vessels. The negotiations culminated in the reorganization trustee promulgating a plan of reorganization recognizing the validity and priority of the Caplan mortgages and incorporating the settlement within it (I 28-31, 34-38, 40, 58-62, 75-77, 80, 84-87, 111, 114-117, 120, 123, 135-137, 181, 185, 443, 446-450, 452-456, 458-460). The trustee reported to the District Court that the settlement would eliminate protracted litigation which, if Caplan prevailed, would render reorganization "impossible by reason of foreclosure of the vessels subject to the Caplan mortgages" (I 459), whereas a settlement would effect a prompt and successful reorganization through the extinguishment of the secured indebtedness (I 111, 114-117, 453-454, 458-460). The Court observed that there was no question but that Caplan had mortgages on the vessels (I 446, 450, 454-455) and concurred in a settlement as a fair solution (II 372).

The plan was accepted or acquiesced in by every creditor with the single exception of the United States of America;

the latter subsequently consented to the plan of reorganization and to the dismissal of its appeal from the orders of approval and confirmation (I 35-38, 41-44, 48-119, 135-137, 181-185, 249-251).

In consequence, no proceedings were had before the Special Master and the order for his appointment was vacated, the reorganization trustee representing to the Court and the latter finding that the "matters which were to be resolved by the Special Master were amicably resolved" (I 191-193).

The pending second Caplan appeal was then voluntarly dismissed because "the lower Court has entered an order approving a plan of reorganization submitted by [the reorganization trustee] * * * acceptable to" the Caplan mortgagees (I 35-38, 167-168, 301).

Throughout the entire period that the foregoing was happening, petitioner and the SEC expressed no objection to the mortgage claim or its compromise and neither filed objections as expressly provided for in the order appointing the Special Master (I 34, 84-87). Significantly, the SEC's objections to the approval and confirmation of the plan of reorganization (I 121-134, 169-171) and of petitioner to its approval make no reference to the Caplan mortgages. No objections were filed by petitioner to the application for confirmation.

It was not until January, 1960 when the reorganization trustee moved to vest title in the reorganized corporation, that the SEC finally came forward (I 219-232). There was then no showing that anything had been ascertained subsequent to the entrapment of the Caplan mortgagees to their irreparable detriment. On the contrary, the SEC's papers dealt with transactions that had occurred in 1955-

1956-early 1957, all or much of which was ascertainable from the debtor's and public records (I 227-229) and that had been referred to prior to the making of the compromise with the Caplan mortgagees and confirmation of the plan of reorganization. There was no claim of newly discovered evidence (I 219-232).

The position of petitioner had been equally negative. It filed objections to approval of the plan, which were more formal than real; attached thereto was a letter from petitioner's counsel referring to many of the items subsequently covered in the reorganization trustee's report (I 126-134). That letter pre-dated the compromise settlement with the Caplan mortgagees (I 128). Petitioner filed no objections to the petition for confirmation. It is noteworthy that before confirmation of the plan and before filing a fee application, petitioner's counsel wrote a letter, addressed solely to the Court, the reorganization trustee and his counsel, referring to alleged influence by Abrams, but concluding, "* * * I do not wish to rock the boat at this time by filing a formal motion, for there may be some good reason that I do not now see why no motion should be filed. For that reason I have not sent copies of this letter to the usual interested parties, and I hope that you * * * will treat it as an informal administrative inquiry" (I 179-181). No protest was made therein by petitioner against the settlement, the plan, or its confirmation, and to the contrary, it recognized that there was no "salvage" for stockholders (I 186).

It was only after the denial of its fee application (I 185-191) that petitioner became impelled to appeal. Curiously, among the claimed compensable services recited as having been rendered by petitioner were conferences with Arthur H. Shaffer looking towards a plan of reorganization (I 190); inconsistently, much of petitioner's present vitriol is now directed at the pre-reorganization dealings of Shaffer.

In consequence of the investigation of the reorganization trustee, the District Court revoked confirmation and set aside the plan of reorganization (I 324), and on February 6, 1961, entered an order in all essential respects identical with the order from which the second Caplan appeal had been taken (II 624). Again, a Special Master was appointed to hear and consider the objections to the Caplan mortgage claim, determine the amounts and priority of liens, etc. (II 25, 624-626).

In other words, two years after the second Caplan appeal was terminated, the case reverted to the same posture as at the inception, with the enormous difference that in the interim the Caplan mortgagees had been lured into an irretrievable loss of position in reliance on a settlement that was dishonored and ignored. On the third Caplan appeal, the SEC recognized that the Caplan mortgagees had been prejudiced by loss of their "strategic position". Moreover, during the interim, cash recoveries from a charter, an insurance loss, and a sale of one of the mortgaged vessels, which rightfully belonged to the Caplan mortgagees, went to the debtor, and others of the mortgaged vessels deteriorated from use (I 301, 317-320, 498).

All of this occurred notwithstanding that the reorganization trustee conceded that it had been his "intention * * * to settle Caplan's rights * * *" and that "it is true that Caplan ha[d]" fully performed his part of the settlement (Trustee's Br., Dkt. 18475, pp. 29, 30).

After the order of the District Court vacating confirmation of the plan of reorganization was affirmed on appeal, 292 F. 2d 455, cert. den. 368 U. S. 956 (1962), the Caplan mortgagees were again ready to stand their ground and defend their position before the Special Master. Again, at this juncture, proposals to settle were put forward, this time by the committee of unsecured creditors and joined in by the reorganization trustee and his counsel (II 41, 659). Such proposals resulted in the provision for the Caplan

mortgage claim contained in the plan of reorganization that is now before this Court.

In recommending approval of the plan and in response to petitioner's contention that the Caplan mortgage claim might be reduced by litigation, the reorganization trustee stated that he had been "advised by his counsel that the outcome of any such litigation is uncertain" and that the compromise was reasonable (II 661-662). He referred to two actions that had stemmed from his 1960 investigation and stated that they were the only ones "considered worthy of prosecution" (II 662).

In response to questions posed by the SEC, the reorganization trustee stated that he would "be glad to" furnish the basis for the compromise (II 283). The Court thereupon stated that, if the SEC desired to go into the matter at length, the hearing would be "set * * * down for another date" (II 283). The SEC's counsel replied: "I have concluded" (II 283).

The reorganization trustee nevertheless responded to a question previously addressed to him as follows:

> "The compromise on the Caplan claim was worked out between the attorney for the group, my attorney and myself. It was done in a conference the three of us had with the court. It was completed after considerable deliberations and negotiations. It was submitted to the court and approved by the court and that is the way we came about to reach that conclusion." (II 284).

The District Court again stated that additional comments could be filed or another hearing date set, but counsel for the SEC turned his attention to a question that he wished to pose to "counsel for the cash proponents" (II 286).

Counsel for petitioner, who only eight days prior thereto had failed to pose any questions relating to the Caplan claim when inquiring of the trustee as to possible "causes of action" possessed by the debtor (II 42, 87-92), again maintained a discreet silence (II 250-259).

The Court concurred in the reorganization trustee's recommendation and "approve[d] the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required * * *" (II 372-373).

No creditor—including the United States Department of Justice, representing large tax and non-tax claims—expressed oral or written objection to the Caplan mortgage settlement provision, either at the hearings held prior to approval and confirmation of the plan or later when amendments were being considered (II 42, 250, 310, 352-356, 763, 796, 896; III 21-66, 83-189, 284-308).

On the appeal to the Court of Appeals from the order of confirmation of the plan of reorganization (which resulted in a remand to accord priority to United States Government non-tax claims), counsel for the reorganization trustee enumerated the reasons why the Caplan mortgage claim had been compromised, namely:

1. the total amount of $330,000 had been disbursed for the specific purposes set forth above, in this brief (*supra*, p. 6);
2. if enforceable according to its terms, the cash outlay by the time of consummation would exceed $500,000 and/or would involve delivery of assets vital to the debtor's business;
3. settlement reduced the principal sum by $49,500, the elimination of legal fees and reimbursement for substantial expenses, while subordinating the

accrued interest to the status of an unsecured claim, with no privilege of converting the principal amount of the claim into new stock;

4. the participants in the Caplan mortgage would have no representation on the board of directors and no meaningful say in the affairs of the reorganized debtor, except as a small minority shareholder;

5. the mortgage transaction was governed by the laws of the State of New York (New York General Business Law § 374), and petitioner's repeated assertion that the mortgages were usurious was unavailing, and the debtor had received a "present fair equivalent value" within the meaning of § 67 of the Bankruptcy Act; and

6. as the participants had no legal interest in the note and mortgages and taking into consideration the fact that there had been assignments of interest by certain initial participants, there were no "mutual debts or mutual credits between the estate of a bankrupt and a creditor" within the meaning of § 68 of the Bankruptcy Act and no offsets were available (Trustees Br. Dkt. 19996, pp. 43-51).

At hearings subsequent to the remand, counsel for the SEC limited his inquiry with respect to the Caplan mortgages to whether:

1. "any attempt [had been made] to negotiate some agreement more favorable to the estate" (III, 45, 46);

2. any litigation would be instituted with respect to the Caplan transaction (III 192); and

3. the Caplan group would accept the plan as amended (III 199).

The plan was approved without objection by any interested party, and subsequently confirmed (III 316-328).

The Caplan mortgagees were, by order of the District Court, required to surrender and satisfy their mortgages (Appendix pp. 35-37).

Opinions Below

The District Court, in its opinion and order filed July 11, 1962 approving the internal and cash plans of reorganization, recited the following:

> "* * * the trustee and unsecured creditors committee appointed by the court to represent that class of creditors were given informal permission by the court to contact the principal lien and priority claimants for the purpose of attempting to compromise and settle the issue involving such claims. This was deemed wise because it was apparent that the liquidation of the issues involved particularly the objection * * * to the Caplan * * * claim * * * would take possibly years to conclude and it was the opinion of the court as well as the trustee and the creditors committee that the financial success of the trusteeship required the early reorganization of the debtor if at all possible." (II 372)

It then stated that such negotiations had resulted in the compromises contained in the proposed internal plan of reorganization, which the Court held to be:

> "* * * fair and equitable under the circumstances and they are hereby approved for inclusion in the internal plan. The court approves the opinion expressed by the attorney for the trustee that no better compromise can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would other-

> wise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the stockholders committee is too remote for serious consideration * * * the alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and unnecessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act." (II 372-373)

The Court of Appeals ultimately affirmed, holding that no creditor had objected and that the compromises constituted a "normal part of the process of reorganization", quoting from *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130 (1939).

Summary of Argument

The Caplan first preferred ship mortgage claim represents $330,000 in fresh new money that was loaned to the debtor, of which more than two-thirds redounded to the advantage of the United States Government by reducing its liability on a mortgage insured by the Martime Administration. Most of the balance of the money cleared liens to which vessels of the debtor would otherwise be subject.

The debtor's present liability to the Caplan mortgagees substantially exceeds $550,000, which has been compromised under the challenged plan of reorganization for less than one-half, *i.e.*, $250,000 in cash and a non-priority general claim for defaulted interest.

Every minute detail of the claim and of every person interested in it, previously and now, has been subjected to the most rigorous scrutiny and searching investigation. The record contains all the parol and documentary evidence that the combined skill, research, and persistence of the

many counsel for petitioner, the SEC, the reorganization trustee, and the creditors—interrogating separately, *seriatim*—were able to adduce. It consists of over 2,200 pages of testimony by 33 witnesses, taken over a period of five months, and more than 60 exhibits, in addition to the deposition of counsel for the Caplan mortgagees taken to establish the validity of the mortgages.

When the provision in the reorganization plan compromising the Caplan mortgage claim was approved, the District Court was in a position to make a reasoned, objective, meaningful evaluation of the claim. Not only did it have all that material before it, but also the vast accumulated information obtained over several years from multifarious proceedings involving the claim and which resulted in three separate appeals to the Court of Appeals.

The briefs of petitioner and the SEC fail to indicate any aspect of the claim either missing from the record or that further exploration would produce. That is particularly pertinent when taken in the context that when given ample opportunities to inquire both petitioner and the SEC failed to do so. Thus: (a) when a deposition was taken to prove the validity of the Caplan mortgages, both petitioner and the SEC, although given notice, defaulted; (b) for a period of more than two years neither petitioner nor the SEC filed any objections to the Caplan mortgage claim; (c) when SEC counsel interrogated the reorganization trustee as to the reasons for the compromise, and the District Court offered to permit SEC counsel to continue the interrogation at a continued hearing or to submit written comments, the reply was, "I have concluded"; and (d) at such hearing—as well as at other hearings—petitioner's counsel made no inquiry.

Settlement of a claim is a routine and "normal part of the process of reorganization", *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130 (1939). The exercise by a District Court of its discretion in approving such a

settlement is, as the Courts of Appeals have held, not to be set aside unless clearly wrong. *In Re Riggi Brothers Co., Inc.*, 42 F. 2d 174 (2nd Cir., 1930), *cert. denied sub nom. Wood & Selig* v. *Todd*, 282 U. S. 881 (1930); *In re Prudence Co., Inc.*, 98 F. 2d 559 (2nd Cir., 1938), *cert. denied sub nom. Stein* v. *McGrath*, 306 U. S. 636 (1939). This is especially true where a review of the record in its entirety demonstrates that the party seeking to upset the settlement was aware of the controversy to be settled and was able to evaluate its merits. *In re Kansas City Journal Post*, 144 F. 2d 816 (8th Cir., 1944); *Fernow* v. *Gubser*, 136 F. 2d 971 (10th Cir., 1943); *Scott* v. *Jones*, 118 F. 2d 30 (10th Cir., 1941).

The briefs of petitioner and the SEC are significantly silent in specifying any infirmity in the mortgage claim or in citing any authority that precludes enforcement. From time to time three claimed defenses have been asserted none of which has any merit:

(a) Usury—The transaction by its terms and by reason of all its phases having occurred in New York, was subject to the laws of that State. The New York General Business Law specifically provided that:

> "No corporation shall hereafter interpose a defense of usury in any action."

The decisions are unanimous that there is no validity to that defense. *Manufacturers Finance Co.* v. *McKey, Trustee in Bankruptcy*, 294 U. S. 442, 452 (1935); *Hubbard* v. *Tod*, 171 U. S. 474, 501 (1898). See also, *Jenkins* v. *Moyse*, 254 N. Y. 319, 172 N. E. 521.

(b) Fraudulent transfer under § 67 of the Bankruptcy Act —It is conceded that the Caplan mortgagees invested $330,000 and that the corporation used those sums to pay its obligations. Financing was not available on more advantageous terms, and stockholders and creditors alike all received the advantages of the mortgage transaction with-

out which an immediate bankruptcy would have occurred. The debtor received "a present fair equivalent value" within the meaning of § 67 of the Bankruptcy Act.

(c) Potential Claims Against individual participant—The note secured by the Caplan mortgages was payable solely to Caplan as trustee, who was the mortgagee named in both mortgages. All benefits conferred by the mortgages redounded expressly and exclusively to him or to the successor trustees, who had legal title to the note and mortgages. No direct rights of any kind were conferred on the participants. There exist no "mutual debts or mutual credits between the estate of a bankrupt and a creditor" § 68, Bankruptcy Act; *Dickerman* v. *Northern Trust Co.*, 176 U. S. 181 (1900). This is especially true in view of the many assignments of interest to holders of beneficial interests who were not parties to the original transaction.

In compliance with the District Court order of September 21, 1965, the Caplan mortgagees have satisfied their mortgages and discharged their liens, thus enabling the debtor to obtain new financing and continue in business as a going concern. A new lien now encumbers the vessels which were formerly the subject of the Caplan mortgages, and as to those mortgages the *status quo ante* cannot be restored (App. 35-42).

ARGUMENT

I. The record permits an adequate evaluation of the Caplan mortgage claim, discloses the basis for settlement, and demonstrates that the District Court properly exercised its discretion.

The record contains, and the District Court had before it when the compromise settlement of the Caplan mortgage claim was approved, everything that could be adduced by the combined ingenuity, diligence, research, and perseverance of the various counsel for petitioner, the SEC, and all other parties to the proceeding.

When the Caplan mortgagees originally voluntarily took the deposition of their counsel to establish the "validity" of their claim, neither petitioner nor the SEC saw fit even to attend despite the fact that they were given timely notice. It was stipulated that "all questions propounded" were answered and that "all of [the] pertinent documents were produced" (I 31).

When the reorganization trustee subsequently conducted his investigation, he spent approximately five months in doing so, interrogated 33 different persons, and took over 2,200 pages of testimony. That investigation was characterized by the SEC on the prior appeal as "exceptionally thorough" (SEC brief, p. 31, Dkt. No. 19,996).

The querulous carpings aside, neither petitioner nor the SEC indicates a single respect in which the present record is deficient as to the Caplan mortgage claim or its compromise, or what, if given another chance, could now be added.

The propriety and desirability of settling claims in bankruptcy reorganizations was recognized almost thirty years ago in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130 (1939). This Court there held that claims frequently arise which "may in the discretion of the Court" be more wisely settled than litigated and that such settlements "constitute a normal part of the process of reorganization." Accord, *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 318 U. S. 523, 565 (1943).

Chapter X of the Bankruptcy Act did not circumscribe the Court's power to approve such compromises, Senate Hearings on H. R. 8046, 75th Congress, 2d Session (1937-1938), at p. 126. The criterion is the proper exercise of the District Court's discretion, irrespective of whether the settlement is effected during the course of the reorganization proceedings or in the body of the plan itself. See 6A *Collier on Bankruptcy*, ¶ 8.07, pp. 2431-2433; 2 *Remington*

on Bankruptcy, § 1155, p. 636; 8B C.J.S. *Bankruptcy*, § 910, p. 754; Bankruptcy Act, §§ 27, 102.

Unless the District Court can be said to have been "clearly wrong" in approving a compromise, its discretion will not be set aside. *In re Riggi Brothers Co., Inc.*, 42 F. 2d 174 (2nd Cir., 1930), *cert. denied sub nom. Wood & Selig* v. *Todd*, 282 U. S. 881 (1930); *Connecticut Railway & Light Co.* v. *New York, New Haven & Hartford Railroad*, 190 F. 2d 305 (2nd Cir., 1951); *In re Prudence Co., Inc.*, 98 F. 2d 559 (2nd Cir., 1938), *cert. denied sub nom. Stein* v. *McGrath*, 306 U. S. 636 (1939).

There is no requirement that the District Court litigate objections to claims or adjudicate the issues. As the Fifth Circuit held in *Florida Trailer Equipment Co.* v. *Deal*, 284 F. 2d 567 (1960), "the very uncertainties of outcome in litigation as well as the avoidance of wasteful litigation and expense" is at the foundation of the power to compromise. See *In Re Prudence Co., Inc., supra*, at 98 F. 2d 559.

In *Riggi, supra*, the validity of a mortgage was questioned; the District Court's approval of a compromise was upheld because:

> "It is quite enough to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. While he might perhaps have succeeded, the nature of the legal problems involved were such that the expense, delay and likelihood of failure may well have made a compromise settlement advisable." (p. 177)

Accord, *In Re Anderson, Thorson & Co.*, 125 F. 2d 325 (7th Cir., 1942); *In Re Albert Harris, Inc.*, 313 F. 2d 447 (6th Cir., 1963); *Scott* v. *Jones*, 118 F. 2d 30 (10th Cir., 1941); *Pullman Couch Co.* v. *Eshelman*, 1 F. 2d 885 (4th Cir., 1926), cert. denied 266 U. S. 631 (1925); *Fernow* v. *Gubser*,

136 F. 2d 971, 972 (10th Cir., 1943); *Daniel Hamm Drayage Co.* v. *Wilson,* 178 F. 2d 633 (8th Cir., 1949); *In re Kansas City Journal-Post Co.,* 144 F. 2d 816 (8th Cir. 1944).

Although both the SEC and the petitioner cite several cases in which reorganization plans were upset on appeal, they do not dispute the authority of the foregoing principles. Moreover, the facts in those cases are sharply distinguishable from the facts in the instant case.

In *National Security Co.* v. *Coriell,* 289 U. S. 426, the receiver had "submitted no facts and made no recommendations". There was no evidence on which the District Court could have found that "a majority of the unsecured creditors favor the plan". In addition, there had been no valuation of assets by a disinterested appraiser, no account of the results of the operations during a five-month period, no account of the results of the operations under the receiver, no independent schedule of liabilities of the corporation showing the number of creditors, the amount owed to each, or the collateral held (289 U. S. at 435-436).

Ashbach v. *Kirtley,* 289 F. 2d 159 (8th Cir., 1961), involved a claim of the debtor that had been reduced to judgment in an amount exceeding $500,000 and settled for one-fifth of that amount, with neither the trustee nor his attorney initially recommending acceptance and with the creditors and stockholders demanding a further investigation to determine whether the judgment debtor had been secreting assets.

Similarly inapposite is *Chicago Rapid Transit,* 196 F. 2d 484 (7th Cir., 1942), wherein the District Court approved an acknowledged "businessman's settlement" of a claim found by the Court of Appeals to be "utterly fantastic" on the record before it. It is pertinent to note that it was held therein: "it may be that the acceptance by a large

majority of creditors and opposition by an inconsequential number or amount would of itself constitute a reasonable basis for approval by the court without consideration of the merits of the claim or claims thus disposed of" (p. 490). See also 2 *Remington on Bankruptcy*, § 1161, p. 644.

Conway v. *Silesian-American Corp.*, 186 F. 2d 201 (2d Cir. 1950), is likewise greatly different from this case. There a plan of reorganization was attacked by creditors as well as stockholders, and the plan itself was predicated upon the trustee's decision not to prosecute claims as to which the Circuit Court found the equities in favor of the estate to be "very strong" as against "essentially no equities whatsoever in favor of [the prospective defendants]".

In addition to relying on wholly inapposite cases, both opposing briefs isolate from their context some quoted excerpts from the testimony of the reorganization trustee and the opinion of the District Court relating to the compromise of the Caplan mortgage claim. Both briefs carefully omit that on the hearings at which the trustee gave the quoted testimony, the Court stated to SEC counsel that it had a "jury out and another one coming on this afternoon" and that if he wished to continue his inquiry the Court would be willing to set the matter down for another day. SEC counsel replied: "I have concluded." (II 283)

The SEC counsel nevertheless, requested that the trustee respond to the question, with which request the trustee complied. SEC counsel did not ask for further time for cross examination or to produce any other evidence. Instead, he stated that he had some comments, and, the Court again reminding him of the time problem, offered to receive the comments in writing or to set another date and that "I [the Court] will be happy to have the Government enter into a consideration of these claims and I invite them to participate in them" (II 283-285).

Throughout all of this, petitioner's counsel—who only days before had questioned the trustee with respect to possible causes of action possessed by the debtor without going into the Caplan claim (II 87-92)—maintained silence.

At two separate hearings after the remand (*United States* v. *Anderson*, 334 F. 2d 111), SEC counsel made no claim that there was inadequate information of record on which to predicate a reasoned judgment, or that the settlement was inappropriate.

Again, petitioner's counsel was deafeningly silent.

As for the District Court, it had been concerned in depth with the Caplan mortgage claim over a period of many years and through multifarious proceedings that led to three appeals to the Court of Appeals.

It is significant that the creditors, whose interests are vitally affected, have not objected to the compromise and, even after receiving the benefits of the views of petitioner and the SEC, still do not object. That is equally true of the United States Department of Justice, representing large tax and non-tax claims, which did not, and does not, object to the plan provision for the Caplan mortgage claim.

It is respectfully submitted that the position of petitioner and the SEC in respect of the Caplan mortgage claim is without merit.

II. The Caplan mortgages are valid and enforceable in the full face amount together with interest and costs.

The Caplan mortgage claim has been assailed on three grounds, none of which has validity.

1. *Usury*—Because the debtor, for the sum of $330,000 advanced to it, issued both a note, secured by mortgages in that amount, and 49,500 shares of stock.

Among the written representations made by TMT to induce the making and effectuating of the transaction was the following:

> "All elements of the loan transaction involving the indebtedness of TMT Trailer Ferry, Inc. to Alex Caplan, as Trustee under indenture dated May 31, 1957, in the sum of $330,000, having occurred within the State of New York, including, among other factors, negotiation of said loan, the making, execution and delivery of said instruments, the payment of the consideration therefor, and payment thereof being due within the State of New York, it is the intention of TMT Trailer Ferry, Inc. to be bound by the laws of the State of New York in respect of said loan transaction and all aspects thereof including but not limited to enforcement of the mortgages securing said loan, and that said loan transaction and all instruments executed in connection therewith and as collateral security therefor, shall be interpreted under and governed by the laws of the State of New York." (I 33-34)

The undisputed testimony establishes that each such recital was literally and precisely true (I 31).

Section 374 of the New York General Business Law mandates that:

> "No corporation shall hereafter interpose the defense of usury in any action."

The decisions are unanimous on this point:

Jenkins v. *Moyse,* 254 N. Y. 319, 172 N. E. 521 (1930);

New York Credit Men's Association v. *Manufacturers Discount Corp.,* 298 N. Y. 512, 80 N. E. 2d 660 (1948);

Hubbard v. *Tod,* 171 U. S. 474, 501 (1898);

Manufacturers Finance Co. v. *McKey, Trustee in Bankruptcy,* 294 U. S. 442, 452 (1935).

2. *Fraudulent Transfer Under § 67 of the Bankruptcy Act*—As the debtor required cash, the Caplan mortgagees paid "a present fair equivalent value" for the note and mortgages, and better terms were unavailable elsewhere. Subdivision (6) of § 67-(d) provides that "such purchaser, lienor, or obligee, who without actual fraudulent intent has given a consideration less than fair as defined in this subdivision (d) for such transfer, lien, or obligation, may retain the property, lien, or obligation as security for repayment". Survival of the debtor and revival of its fortunes was plainly anticipated as evidenced by the fact that the note was non-interest bearing until its stated maturity and was then convertible into stock. Manifestly, the Caplan mortgagees did not invest $330,000 in new money in order to purchase the problems attendant on a bankruptcy or reorganization proceeding.

In *Asel* v. *Cook,* 23 F. 2d 256 (8th Cir. 1927), it was held that a factor to be taken into account in determining fair value is that "the Corporation was critically embarrassed by large indebtedness shortly coming due and by urgent need of new capital" and that "After endeavoring to raise the necessary funds from other sources, the managing officers of the Corporation applied" to the creditor whose transaction was attacked (p. 257). The Court held that the transaction had been "fully executed upon both sides and it is impossible to place the parties as they were before such execution. To grant the relief here sought would give the Corporation creditors all of the advantages resulting from the contract * * *. Such a contention makes no legitimate appeal to a court of equity" (p. 257).

To the same effect:

Kenneally v. *Standard Electronics Corp.,* 364 F. 2d 642 (8th Cir. 1966).

See also *Matter of Peoria Braumeister Co.*, 138 F. 2d 520 (7th Cir. 1943), in which, notwithstanding that the consideration was unfair, the chattel mortgage therein involved was held enforceable to the extent of the amount actually advanced.[6]

3. *Potential Claims Against an Individual Participant*— The note on which the Caplan mortgages rest is payable solely to Caplan, as trustee, who is the mortgagee named in both mortgages. All benefits conferred by the mortgages redound expressly and exclusively to the mortgagee, namely, the trustee-successors to Caplan, trustee, who have legal title to the note and mortgages; no direct rights of any kind are conferred on the participants. The Caplan trustees may enforce the mortgages according to their terms, free of claims assertable against any participants, who have no legal interest in the note and mortgages, and who by express language in the trust indenture are relegated solely to the right to receive a certificate of beneficial interest from the trustees. Moreover, if any claims were asserted by the reorganization trustee against an original participant whose interest in the transaction had been assigned (*e.g.*, Bostwick-Westbury Corporation, in which Abrams' daughters had an interest, and whose participation in the Caplan mortgages was transferred), it would not adversely affect enforceability of the note and

---

[6] Petitioner erroneously refers to the trustee's report of investigation and claims that there has been a "proven" fraud. The District Court disavowed having reached any such conclusion (Hearing 1/27/61. p. 15).

Both SEC and petitioner, without benefit of record references, seek to further color the proceedings by adverting to an alleged agreement between the Caplan mortgagees and Merrill Stevens to procure acceptance of the 1959 plan of reorganization. The fact that the successor trustee (Worton) indicated that there had been a "misunderstanding" (Hearing 6/29/59; I 39-40) and offered no evidence in support of his petition to vacate the plan of confirmation is omitted from the recitation of facts.

mortgages. An assignee's interest is not subject to satisfaction of his assignor's obligation.

§ 68 of the Bankruptcy Act provides for set-offs where there are "mutual debts or mutual credits between the estate of a bankrupt and a creditor". That provision is applicable to Chapter X. *Moore on Corporate Reorganization,* Vol. 2, pp. 2819-2820), ¶9.09; *Matter of Rosenbaum Grain Corporation,* 103 F. 2d 656 (7th Cir. 1939); *In re Busch Terminal Co.,* 93 F. 2d 661 (2d Cir. 1938). Debts or credits must be not only mutual but "in the same right and between the same parties, standing in the same capacity". 4 *Collier on Bankruptcy,* 14th Ed., pp. 726-728, ¶68.04.

Dickerman v. *Northern Trust Co.,* 176 U. S. 181 (1900), was an action to foreclose a mortgage given to secure the underlying bonds that were originally issued to investors, who also received stock as a bonus, and to promoters who were charged with fraud. In affirming a decree of foreclosure, it was held that "the bonds must be treated as an entirety" (p. 206) and that:

> "Assuming these facts to have made out a case of fraud in the organization of the Straw Paper Company, and in the purchase of the mill properties, it is difficult to see how they affect the validity of the bonds as a whole, the right of the trustee to foreclose, or how they can entitle the complainant to compel the bondholders, so far at least as they were innocent holders, to set off their indebtedness to the paper company for stock, against the indebtedness of the company upon the bonds." (p. 200)

See also, 37 Am. Jur. *Mortgages,* § 578.

There being no valid defenses to the Caplan mortgage claim, and there being ample support of record for its compromise, and the mortgage liens having been discharged

and superseded by a new subsequent lien, the position of the petitioner and the SEC is unwarranted as a matter of law and is inequitable.

CONCLUSION

The provision in the plan of reorganization relating to the Caplan mortgages meets all statutory requirements and should not be disturbed.

Dated: New York, New York, October 20, 1967.

Respectfully submitted

M. James Spitzer
Ronald J. Offenkrantz
Jackson L. Peters
Attorneys for Respondents,
Caplan Mortgagees

Knight, Smith, Underwood & Peters
Spitzer & Feldman
of Counsel

APPENDIX

District Court Order, dated September 20, 1965.

IN THE

DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

IN BANKRUPTCY—No. 3659-M

In the Matter of:

TMT TRAILER FERRY INC. et al.,

Debtors.

ORDER APPROVING AMENDMENT TO INTERNAL PLAN OF REORGANIZATION AS AMENDED

This cause came on for hearing on the Trustee's Proposed Amendment to the Plan of Reorganization which amendment would provide for payment of $250,000 in cash upon the consummation of the Plan to the holders of the Caplan Mortgage claims. The Plan as it now exists provides for payment to said claimants of $280,500 over a period of five (5) years with certain deferred payments bearing interest at 6% per annum secured by a lien on one of the vessels of the debtor. No other changes are proposed in the other provisions of the Plan for the settlement of the Caplan Mortgage claims.

It appears that the proposed settlement has been approved by the Board of Directors of the reorganized debtor, and it is the opinion of the court that the proposed modification of the Plan does not materially and adversely affect the interests of creditors and stockholders, but on the

contrary is in the best interests of the debtor and of the reorganized company.

It has been further shown by evidence before the court that the debtor will be able to pay the $250,000 required on consummation by the proposed amendment, and will have sufficient funds to do so without impairing the financial stability of the reorganized company. It further appears that notice has been given to parties in interest that a proposed favorable cash settlement of these claims would be presented to the court at the hearing held in this cause on September 20, 1965, and that further notice of the proposed amendment to the Plan of Reorganization is not required. Wherefore it is

ORDERED, ADJUDGED and DECREED that Paragraph 2 of Part III of the INTERNAL PLAN OF REORGANIZATION AS AMENDED is hereby amended so as to read as follows:

> 2. The creditors in Class 4 shall be paid as follows: The Caplan Mortgage claim which is in the principal sum of $330,000 plus interest, costs and attorneys fees, and to which various objections have been filed by the Trustee and others, shall be compromised and settled for the purpose of this plan, and this plan only, as follows:
>
> a. The principal sum is reduced to $250,000 and will be paid in cash upon substantial consummation of the plan of reorganization.
>
> b. The Trustees of the Caplan mortgage shall satisfy their existing mortgages encumbering the vessels TMT PUERTO RICO, TMT CAROLINA, TMT GEORGIA and TMT CUBA.
>
> c. This claimant is allowed an unsecured claim for a sum equal to 6% interest on $280,500 from January 3, 1958, to the date of payment of the said

$250,000. Such claim shall be treated the same as the unsecured claims provided for in paragraph 6 below.

d. This claimant waives all claims for costs, attorneys fees, interest, and all other claims against the debtors other than those set forth above.

DONE and ORDERED at Miami, Dade County, Florida, this 20th day of September, 1965.

EMETT C. CHOATE,
United States District Judge.

Certified to be a true and correct copy of the original.
Joseph I. Bogart, Clerk
U. S. District Court
Southern Dist. of Fla.

By Jerry F. Haven
Deputy Clerk

Date: 10-16-67

District Court Order Approving Loan to Reorganized Company.

IN THE

UNITED STATES DISTRICT COURT

IN AND FOR THE SOUTHERN DISTRICT OF FLORIDA

MIAMI DIVISION

IN BANKRUPTCY—No. 3659-M

In the Matter of:

TMT TRAILER FERRY INC. et al.,

Debtors.

ORDER APPROVING LOAN OF $1,250,000 TO THE REORGANIZED COMPANY

THIS CAUSE came on for hearing September 20, 1965, pursuant to proper notice to parties in interest, on the Trustee's PETITION FOR SUBSTANTIAL CONSUMMATION OF PLAN OF REORGANIZATION. Among the essentials for consummating the plan is the $1,250,000 loan which the reorganized company is authorized to make pursuant to Paragraph 3 of Part VII of the INTERNAL PLAN OF REORGANIZATION AS AMENDED.

The Trustee, with the approval of the new Board of Directors of the reorganized company, has negotiated the required loan with The Florida National Bank of Jacksonville. Attached hereto is a copy of the proposed Promissory Note. The loan is to be secured by mortgages in conventional form encumbering the five vessels now owned by the debtor and all of the motor vehicle equipment of the debtor. All costs and expenses of the loan are to be paid by the borrower, including reasonable attorney's fees

for the lender's counsel. It is understood that the borrower may not require the full amount of the $1,250,000 loan and may draw the amounts required by it in varying amounts from time to time, in which events interest will be charged only on unpaid balances.

All of the assets and property of the debtor will be transferred by the Trustees to the reorganized company with the exception of certain choses in action and funds required to secure the payment of unliquidated claims payable in full in cash. A portion of the proceeds of the $1,250,000 loan will be required to create such funds. Reference is made to a companion order entered this day entitled ORDER APPROVING CONSUMMATION OF PLAN OF REORGANIZATION for provisions governing the creation of these funds, totaling $1,116,615.60, and transferring to said funds all unliquidated claims and liens against the debtor required to be paid in full in cash. This will leave the assets and property of the reorganized company free and clear of any claims or liens against the debtor except for current liabilities, and will enable the loan from the bank to be secured by a first lien against the vessels and vehicle equipment of the reorganized company.

No objections have been made to the making of this loan by the reorganized company and it is in the best interests of the debtor and should be approved.

Wherefore it is

ORDERED, ADJUDGED and DECREED as follows:

1. The proposed loan of $1,250,000 by The Florida National Bank of Jacksonville to the reorganized debtor company, TMT Trailer Ferry, Inc., a Delaware corporation, upon the terms as outlined herein, be and the same is hereby APPROVED.

Promissory Note Attached to Order Approving Loan to Reorganized Company.

2. The said loan will be secured by a first lien encumbering the five vessels now owned by the debtor and all of its motor vehicle equipment, and all such encumbered property will be free and clear of all claims and liens against the debtor and its property.

3. The Trustee, C. Gordon Anderson, and the officers and directors of the reorganized company are authorized and directed to execute any documents required to consummate said loan and to take such further actions as may be necessary or expedient in their discretion in closing said loan.

DONE and ORDERED at Miami, Dade County, Florida, this 28th day of September, 1965.

s/ EMETT C. CHOATE,
United States District Judge.

Promissory Note Attached to Order Approving Loan to Reorganized Company

$1,250,000.00 Miami, Florida

August , 1965

ON OR BEFORE the day of October, 1969, FOR VALUE RECEIVED, the undersigned promises to pay to the order of THE FLORIDA NATIONAL BANK OF JACKSONVILLE, at its banking offices in Jacksonville, Florida, or at payee's option, at such other place as may be designated from time to time by the payee, the principal sum of ONE MILLION, TWO HUNDRED FIFTY THOUSAND AND NO/100 ($1,250,000.00) DOLLARS, together with interest thereon at the rate of six per cent

(6%) per annum, from and after the date hereof, the principal indebtedness evidenced hereby and interest to be paid in installments as follows:

> Principal payable in fifty (50) equal monthly installments of TWENTY-FIVE THOUSAND ($25,000.00) DOLLARS each, beginning with the day of September, 1965, and continuing thereafter in equal monthly installments of like amount, on the day of each and every month thereafter, to and including October , 1969. Interest payable monthly, concurrently with principal payments.

Maker reserves the privilege of prepaying, without penalty, all or any part of the indebtedness evidenced by this note, principal and interest; however, in the event of partial prepayment, the same shall not relieve the maker or endorsers from the obligation of paying the installments as they become due and payable according to the tenor hereof.

This note is secured by a chattel mortgage encumbering personal property owned by the Mortgagor, together with mortgages encumbering the following vessels: TMT "SAN JUAN" TMT "GEORGIA," TMT "CAROLINA," TMT "BISCAYNE" and TMT "FLORIDA." The covenants and conditions set forth or referred to in said mortgages are hereby incorporated in this note as covenants and conditions of the undersigned, with the same force and effect as though such covenants and conditions were fully set forth herein.

If default be made in the payment of any installment of principal or interest or in respect to any of the said covenants or conditions of the aforementioned mortgages, then, at the option of the holder hereof, the entire prin-

cipal sum remaining unpaid, together with accrued interest, shall become immediately due and payable without notice.

The maker and each endorser hereof further agrees, jointly and severally, to pay all costs of collection, including a reasonable attorneys' fee, in case the principal of this note, or any payment on the principal or any interest thereon is not paid at the respective maturities thereof, or in case it becomes necessary to protect the security hereof, whether suit be brought or not.

The maker and endorsers hereof severally waive demand, protest and notice of maturity, nonpayment or protest and all requirements necessary to hold each of them liable as maker and endorsers.

Deferred principal and interest payments shall bear interest at the rate of eight per cent (8%) per annum from their respective maturities until paid.

TMT Trailer Ferry, Inc.

By .....
President

Attest:

.....
Secretary

District Court Order Approving Consummation of Plan of Reorganization.

IN THE

DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF FLORIDA
MIAMI DIVISION

IN BANKRUPTCY—No. 3659-M

In the Matter of:

TMT TRAILER FERRY INC. et al.,

Debtors.

ORDER APPROVING CONSUMMATION OF PLAN OF REORGANIZATION

This cause came on for hearing on September 20, 1965, pursuant to proper notice to parties in interest on the Trustee's PETITION FOR SUBSTANTIAL CONSUMMATION OF PLAN OF REORGANIZATION. It appears that pursuant to previous orders of this court the Trustee has taken certain steps toward consummating the plan. The initial meeting of the Board of Directors of the reorganized company has been held and a copy of the minutes thereof filed in this cause. No objection has been made to any of the actions taken at said meeting and it appears that all of the matters decided were consistent with the plan of reorganization in the best interests of the debtor and should be approved by the court.

The Trustee has presented evidence outlining his plans for paying those claims required to be paid in cash upon consummation and it appears that such claims total $1,446,030.56 of which $1,116,615.60 are governmental

claims in classes 1, 2 and 3 which have not been the subject of orders of the court determining the exact amount to be paid. The plan of reorganization provides that any such unliquidated claims shall be protected upon consummation by setting aside under the Trustee a sum sufficient to pay such claims in full. The Trustee will be directed to create such a fund of $1,116,615.60 at the time of substantial consummation for the benefit of the following unliquidated claims:

a) For all claims of the United States of America for taxes, being all of the claims under Class 1	$ 192,101.68
b) For all other claims of the United States of America, generally referred to as the government non-tax claims, and being all of the claims in Class 2	904,737.84
c) For all of the tax claims of other governments and political subdivisions thereof in Class 3, *except* claims of the Commonwealth of Puerto Rico*	19,776.08
Total	$1,116,615.60

The Trustee also presented evidence outlining his plans for issuing the new common stock of the reorganized company to creditors entitled thereto under the plan. The claims involved total approximately four million dollars, including $189,300 in debenture bondholder claims that have not been liquidated as to the exact amount due each claimant, and the Trustee proposes to issue to each creditor

*Claims of the government of Puerto Rico have been liquidated and allowed by the court in amount of $63,947.25.

entitled to stock one share for each $3.10 of his claim with no fractional shares to be issued. This will dispose of approximately 1,300,000 shares, the number provided for in the plan.

The Trustee also presented evidence showing pro forma balance sheet of the reorganized company after giving effect to transactions required to consummate the plan, and it appears that consummation at this time will be feasible. The debtor will require the proceeds of the $1,250,000 loan which the plan authorizes the reorganized company to make. The Trustee has advised that the loan is available from The Florida National Bank of Jacksonville on conventional terms and within the provisions of the plan. A separate order will be entered specifically approving the terms of this loan which will be secured by a first lien on all the assets of the reorganized company and will constitute its only indebtedness other than current liabilities arising out of the normal operation of the business.

The Trustee desires to proceed promptly with the consummation of the plan and the transfer to the reorganized company of all assets of the debtor other than those to be retained in the Trusteeship under the plan. It is the opinion of the court that the plan should be consummated without further delay.

WHEREFORE, it is

ORDERED, ADJUDGED and DECREED as follows:

1. All actions taken by the new directors of the reorganized TMT TRAILER FERRY, INC. at their organization meeting held in Miami, Florida, on August 23, 1965, as shown by the minutes of said meeting filed herein by the Trustee on September 9, 1965 are hereby RATIFIED and APPROVED, and the officers and directors of the reorganized

company are authorized to take such further actions as may be required to carry out those approved at said meeting and to operate the business of the debtor subject to such restrictions as are contained in the plan of reorganization upon the transfer of its assets by the Trustee to the reorganized company.

2. The Trustee is ordered and directed, upon the consummation of the $1,250,000 loan to be obtained by the reorganized company from The Florida National Bank of Jacksonville, to deposit in a separate bank account the sum of $1,116,615.60 for the benefit of all claimants in Classes 1, 2 and 3 whose claims have not been liquidated as stated heretofore in this order.

3. The claims and liens of all creditors in Classes 1, 2 and 3 (other than the claims of the Commonwealth of Puerto Rico) are hereby transferred to the fund of $1,116.615.60 to be created pursuant to paragraph 2 above, and the claimants in Classes, 1, 2 and 3, after the creation of said fund, shall have no claim against any of the other assets of the debtor and shall thereafter have no claim against any of the assets of the reorganized company.

4. The Trustee is ordered and directed to proceed promptly to liquidate, and determine the proper amount of all claims in Classes 1, 2 and 3 which are to be secured by the $1,116.615.60 fund created pursuant to paragraph 2 above, and to pay said claims from said fund.

5. The Trustee is ordered and directed to pay all liquidated claims required by the plan of reorganization to be paid in cash upon consummation of the plan, when the proceeds of the said $1,250,000 bank loan are available.

District Court Order Approving Consummation of Plan of Reorganization.

6. The Trustee is ordered and directed, upon consummation of said $1,250,000 bank loan, to transfer to the reorganized company all assets of the debtor not required by the plan of reorganization to be retained by the Trusteeship, except cash assets required to create the said $1,116,615.60 fund for the benefit of creditors in Classes 1, 2 and 3. All assets transferred to the reorganized debtor shall be free and clear of all claims against the debtor except current liabilities arising from the operation of the debtor.

7. The reorganized company under the supervision and direction of the Trustee, shall issue the new common stock of the debtor to those creditors entitled thereto under the plan or reorganization on the basis of one share of stock for each $3.10 of claim, with no fractional shares issued. Every stock certificate issued shall bear a notation, until the further order of the court, referring to the pending appeals which seek to change certain provisions in the plan of reorganization.

8. The Trustee shall take such further action as may be required to complete consummation of the Plan of reorganization.

DONE and ORDERED at Miami, Dade County, Florida, this .... day of September, 1965.

.....
United States District Judge

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No. 38

In the Supreme Court of the United States

OCTOBER TERM, 1967

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,
PETITIONER

v.

C. GORDON ANDERSON, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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In the Supreme Court of the United States

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PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.,
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REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

We are filing this reply brief to correct possibly misleading impressions that may be created by respondents' quotations from district court statements by the Commission's counsel and by reference to material that is not part of the record.

1. The quotation on page 15 of respondent Anderson's brief appears to suggest that Commission counsel was of the view that Anderson "should be considered" for the management of the reorganized company. Commission counsel made it abundantly clear at that point, however, that the Commission opposed Ander-

281-289—67

son's appointment to the reorganized company. He stated that "the Securities and Exchange Commission has heretofore filed in this proceeding objections to the Trustee's becoming a salaried officer of the reorganized debtor and expects to support the Stockholders' Committee on that issue in the appeal"; that "we take the view it is not in the public interest to appoint the Trustee as manager" (II 995); and that, although the trustee might be "able and capable," a trustee who "has an interest in the future outcome of the proceedings would not be able to act impartially as we feel Congress intended * * *" (II 995–996). In the face of these unequivocal statements the noncommittal comment that Anderson "should be considered" obviously did not have the meaning or significance Anderson apparently ascribes to it.

2. During Commission counsel's cross-examination of the trustee, he asked the latter to explain the bases of "the alleged compromises of the Shaffer-Spitzer mortgage claim, and the Merrill-Stevens claims" (II 283). When the trustee replied "I will be glad to," the district judge stated that he had a number of other matters to handle, and that "if you are going on here all day, I will just continue this to another day" (*ibid.*). Commission counsel then stated, "I have concluded" (*ibid.*). Respondents Shaffer and Spitzer (the Caplan mortgagees) three times suggest (Br. pp. 17, 22, 28) that by this statement Commission counsel indicated that he was satisfied that there had been an adequate explanation of the bases of the compromises.

The statement does not bear the explanation they ascribe to it. On the contrary, the ensuing testimony and colloquy demonstrate that Commission counsel was stating only that the compromises were the sole remaining subject on which he wanted to cross-examine. Following the "I have concluded" statement the court instructed the trustee to answer the question concerning the bases of the compromises. The trustee then gave his explanation of the Merrill-Stevens settlement (II 283–284). Commission counsel then asked the trustee to answer the portion of the question "directed to the compromise of the Caplan mortgage claim" (II 284). After the trustee explained that compromise, Commission counsel stated:

> There are many factors, of course, which are involved in the compromising of these claims other than those upon which Mr. Anderson has touched. There are some comments that I was prepared to make which, if the Court will give the time, I should like to [II 285].

In response to the court's suggestion, these comments were included in the Commission's memorandum on the proposed plan of reorganization filed shortly thereafter (II 722, 735–740). It stated (II 739) with respect to the treatment of the Caplan mortgage:

> There is nothing in the record to justify the trustee's retreat from * * * [his] prior position in his report [that "causes of action and defenses exist against the holders of the Caplan Mortgage, individually and as a group * * *," II 606].

The memorandum also stated in detail why the settlements of both the Caplan and the Merrill-Stevens claims were unfair (II 735–740).

3. Respondent Anderson's brief (p. 35) refers to "an example of the type of information which the trustee's counsel examined during his investigation, which does not appear of record * * *." This off-the-record "example," suggesting that Merrill-Stevens was not responsible for the breakdown of the Carib Queen, refers to portions of a written report submitted by the Commission to the trustee, which summarized the strengths and weaknesses of the debtor's defenses, offsets, and counterclaims to the Merrill-Stevens claims. The report in its entirety did not convince the Commission that these defenses, offsets, and counterclaims were without merit, since the Commission did not withdraw its previously filed objections to the claims (II 1093). Instead, at about the time the report was being completed, the Commission filed specifications regarding these objections (II 2).

In view of the difference of opinion between the Commission and the trustee as to the merits of these claims and the fact that the trustee himself had moved for a hearing by a Special Master on the Commission's objections (II 862), the trustee should at least have explained on the record the detailed considerations that induced him to reach the settlement with Merrill-Stevens. For without such an explanation neither the court nor the other parties could make any informed

judgment as to whether the compromise of that claim was fair.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

PHILIP A. LOOMIS, JR.,
General Counsel,
DAVID FERBER,
Solicitor,
Securities and Exchange Commission.

NOVEMBER 1967.

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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER FERRY, INC.

Petitioner

v.

C. GORDON ANDERSON, TRUSTEE

Respondent

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF

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---

REPLY BRIEF

Introduction

This reply brief, unlike our initial brief on the merits ("C. Br.") makes no attempt at unified topical presentation, and consists largely of a gloss of annotations on specific passages in the trustee's brief ("T. Br.") and in the brief filed for Messrs. Shaffer and Spitzer, the successor mortgagees on the Caplan mortgage ("S-S. Br."). We shall deal primarily with a few points of fact that we think the trustee and Shaffer-Spitzer have treated less than informatively in their briefing.

We shall not try to grab back from them every straw at which they have snatched. At that, some of our comments may seem to the Court, as they do to us, perhaps too obvious to be worth making, or on points too farfetched in the responding briefs to be worth answering. But we cannot permit conceptions of style and elegance in briefing to risk leaving the case in confusion if reference to what we said in our brief or what the evidence says in the record, may serve to unconfuse. Our opponents' frequent use of matter that is neither the subject of judicial notice nor part of the record lodged here with the petition for certiorari, however, requires initial comment.

On-the-record and off-the-record evidence

We have no objection to the Shaffer-Spitzer brief passages which quote material from testimony and orders that we know actually appeared on the original district court record, e.g. S-S.Br.6,9-10,35 ff., notwithstanding the formality of lodgment with the Clerk of this Court has not been complied with. We have used similar material, set out infra, p.A 1-23, certified copies lodged with the Clerk. Nor do we especially object on the ground of off-the-record to the trustee's use of 1965 and 1966 earnings figures (T.Br.45 n.21). Although not served on the parties these figures were at least filed in the district court and could therefore be similarly certified. We cannot, however, agree to the use of such figures, when presented without the benefit of the cross examination that exposed the trustee's willful downward distortion of his earlier earnings figures, commented on C.Br.47-50.

We do object most seriously, however, to the trustee's repeated reference to documents which never achieved record status at all. Thus he says of certain of his private labors on the Merrill-Stevens claim, including his examination of documents furnished by Merrill-Stevens: "None of this data is shown in the record, but the examination of it was reported to the court by the trustee and his counsel (II 25)" (T.Br. 34). Similarly, the trustee's off-the-record statement attempt-

ing to excuse his failure to acquire new-design vessels to replace the obsolete LSTs: "The major financing required to replace them cannot be had while the trusteeship exists; the Department of Commerce has approved as feasible the guarantee of a large loan for this purpose, but will not consider it as long as the plan of reorganization is under attack in the courts" (T.Br.64), is more of the same. Likewise his purported excerpt from an SEC report of a navy chemical engineer's examination of Coast Guard records of unstated scope is not alone hearsay at least four times removed but illustrates the vice of off-the-record investigation and compromise based thereon, of which we have complained with detailed case law citation (C.Br.24,33ff.). Perhaps the most gross example in the ten-year history of this reorganization, of the unreliability of such unsworn and off-the-record investigation, is that of a Department of Justice attorney for the Government in its capacity as creditor, resulting in his enthusiastic accolade of Shaffer-Spitzer, quoted S-SBr.9-10.

As set out in our brief, when the trustee did get around later to making Shaffer-Spitzer subject of a real § 167 investigation under oath and with the right of examination of all parties (C.Br.8-9) the trustee found unmistakable proof of the very matter that the Department of Justice admiralty lawyer looked for but failed to find:

(1) That the real principals of the Shaffer-Spitzer mortgage were Shaffer himself, and Abrams, the prime wreckers of the company (I 272-291);

(2) That Abrams and Shaffer as financial advisors exercised a high degree of control over the affairs of company (I 262ff.,288);

(3) That the mortgage itself was an unfair and fraudulent transaction (I 282-286).

At least one cause of action against management was also established contrary to the Department of Justice man's anticipation (T.Br.7).

In spite of this horrid example, the trustee now tells the Court he made the same cozy type of investigation of Merrill-Stevens that so nearly allowed Shaffer-Spitzer to escape.

The point we have just made of the impropriety and unreliability of judicial reliance on information acquired off-the-record should hardly have needed pointing out to an experienced district court. Twice, however, the same district judge who had this case in charge has been reversed by the Fifth Circuit for basing decisions as he did here on information he believed he possessed, acquired off-the-record. One of these cases was a reorganization case, *Corr v. Flora Sun Corp.*, 317 F.2d 708: While the district judge's "subjective and independent knowledge * * * may have premised his judgment * * * the present record does not so reflect and is incapable of intelligent review in such regard" (at 710). Likewise in a case not yet reported he was reversed for importing into the record matters within his "extrajudicial knowledge" which are "not to be judicially noticed nor an ingredient in the determination of the litigation". *Fox v. West Palm Beach*, slip opinion p. 13, 5th circuit No. 23947, Sept. 26, 1967. Cf. *Sanders v. Beach*, 283 F.2d 946 (CA 10).

In this case too, on innumerable points, the court acted as an expert witness not subject to cross-examination (e.g. II 75, 76-7, 79, 80, 143, 160, 171, 310.27, 310.34, 310.45, 346.1, 915), and the trustee repeatedly relies on information allegedly given to the judge off-the-record but not given to the parties and never subject to adversary challenge.

The Trustee's Brief

The trustee's brief does not question certain fundamental points:

The trustee does not deny that public investors have been innocent victims of stock frauds by the cloaked owners of the Caplan mortgage.

The trustee does not deny the existence of a conflict of interest arising from his duties as a fiduciary and his expectation of continuing employment by the reorganized company.

The trustee does not deny that he made no on-the-record § 167 investigation of Merrill-Stevens.

The trustee does not deny that the Board of Directors that nominated him for president and will pass on his emoluments consists entirely of insiders: 2 patronage beneficiaries who were also discount buyers of claims, 2 representatives of Merrill-Stevens who is the beneficiary of his suppression of § 167 investigation, and the trustee's general manager and attorney.

The trustee does not deny that he and his insider allies blocked any cash plan.

The trustee does not deny that his and the district court's valuation of the debtor was solely based on past earnings.

The trustee does not deny that the stockholder claim to creditor treatment was never heard.

The trustee does not deny that the delay in reorganization, 1959 to 1965, was the result of his errors in 2 invalid plans later set aside as a result of appeals.

On these points, essentially undisputed, we feel the case turns. We are compelled however to reply to certain specifically misleading assertions:–

Trustee's brief, p. 7: the trustee's failure to assert certain causes of action: – The trustee, without citation to the paragraph of our brief that he criticizes, complains that we "imply that the trustee has not pursued causes of action against persons responsible for the mismanagement of TMT before the reorganization proceedings began. The truth is, as everyone involved well knows, that two suits were brought to recover damages against many of the persons responsible". He then points to a pending suit he brought against persons not including Shaffer, arising out of a Wilmington property

purchase, and to a suit he brought against Rath, ex-president of TMT, in which he has achieved judgment although no recovery.

In the passage in our brief in which we taxed him with so letting causes of action lapse, we conceded he had brought that very Wilmington suit (C.Br.30). But he never followed through on his own 1960 recommendation for suits and counterclaims against Shaffer, Abrams, Erdman, et al. on the Bellanca stock swap deal and several quite other instances of diversion of corporate opportunity and of private profit from sales of company stock (I 263-4, 286, 289, 291, 294). More important, our briefing there was directed to his treatment of the Shaffer-Spitzer mortgage, viz. his failure to assert these causes of action against mortgage participants either by way of counterclaim against the mortgage or by way of separate suits; and worse, that for three years he hid the fact that stifling those causes of action was covert part of the 1962 Plan II "compromise" with Shaffer-Spitzer (C. Br.30). This he has not answered.

We note infra, p. 15, in response to Shaffer-Spitzer's assertion that there was a full disclosure as to them (S-SBr.9 ff.), the later unmasking that the plan included boot to Shaffer's wife who had been privy to his deals, by way of allowance of her hidden $115,000.00 debenture creditor claim.

Trustee's brief, p 20: "Law of the Case": The Court of Appeals on the third appeal repudiated the trustee's broad "law of the case" contention, 364 F.2d 936, 938-9. The trustee still urges, however, the Fifth Circuit's rejection on the second appeal of the contention that the trustee was disqualified as a matter of law, as precluding us from contending that the plan is invalidated because promulgated by a trustee who had put his independence in pawn through conflict of interest. The trustee's argument ignores the express proviso of the Fifth Circuit's opinion that it did not preclude disqualification in fact on a specific showing. Since we continued to assert the existence of such disqualification

in fact, and renewed it on the remand in the precise terms of the Court of Appeals reservation of the issue, we were on no possible construction barred by "law of the case." Moreover, as we pointed out in our Petition for Certiorari p. 14, the remand of Plan II by the Fifth Circuit deprived the advisory ruling of finality, since a new Plan III which the Court of Appeals itself anticipated might be developed, 334 F.2d 118, 119, might well have made the question moot. This is also the thrust of the cases cited in the SEC's Brief p. 23, which the trustee has not mentioned or answered at all.

Trustee's brief p. 20-21: – purported failure of the stockholders committee to object to the new management: – The trustee points out, for once with record citation, III 351 ff. that when the board of directors came up for court approval on confirmation of Plan III there were no objections "*even from counsel for the Stockholders Committee* who was present" (trustee's emph.). He omits to report that committee counsel had just been peremptorily gagged. On the very page before, the record reads:

> "THE COURT: By the way, Mr. Trustee, prepare a rescission of the order authorizing him to represent a Stockholders' Committee – and to get rid of that right now.
>
> MR. LANGBEIN: Is that order effective immediately, your Honor?
>
> THE COURT: Immediately."
>
> MR. LANGBEIN: The Court no longer wishes to hear me in these proceedings?
>
> THE COURT: * * * Your authority will be rescinded." (III 350-1)

At that, no one in the case could doubt our position, of vehement objection to a board comprised of the trustee and his pals. Our Plan II appeal had raised the point, and when Plan III was promulgated we had raised it again in a formal pleading (III 244-5).

Trustee's brief, p. 28: the need for investigation of new management: – The trustee asserts that we made an "unwarranted assumption * * * of improper affiliations" when we asserted C.Br.36ff, the need for § 221(5) investigation of new management's affiliations, for he says there was nothing about new management to investigate, since it was either all spread on the record or known to all off-the-record. For our criticism of the trustee's substitution of off-the-record for on-the-record, see supra p. 2. Investigation necessary to comply with § 221(5), however, covers not merely the fact of affiliations but the "good faith" of the plan and whether the appointments are "consistent with public policy". This we elaborated, C.Br.38-9, in terms of the propriety of investigating the egregious bank loan discussed C. Br.54, to say nothing of the need for weighing against the quoted statutory tests a new management that included patronage beneficiaries whose purchase of claims protected their patronage, and persons under unrebutted charges of pre-reorganization fraud.

Trustee's brief p. 29: "no appeal has been taken" from the towing contract: – Not so. Notice of Appeal from Order Approving Renewal of Towing Contract, III 212; Statement of Points on Appeal III 382.

Trustee's brief p. 36: defenses against Merrill-Stevens:– "All the issues concerned [Merrill-Stevens] tort liability for results of its work and whether some of the work could properly give rise to maritime liens against the vessels". Not so. Contract defenses were asserted and more importantly, unanswered charges of collusion with TMT, Abrams and Shaffer, to defraud Maritime Administration and public investors (II 362, 367, 1046,1066-7,1072.1-.4,1077; III 18; see also during-reorganization fraud I 236), summarized principally at C Br 26. In addition to the charges we made and specified and for which the trustee's own report laid substantial foundation (I 261,271), we sought by discovery proceedings to obtain for the record further documentary proof of these matters, which we had located and identified. The trustee had admittedly never seen these documents but discovery was actively and successfully opposed by him, C Br 26-7.

Trustee's brief p 49: cash bids and solvency: – The Trustee says that to compare the cash offer with the insolvency finding of value, it is necessary to subtract the the current liabilities because they would have to be paid out of the cash bid. This is wrong. Current liabilities would have to be paid in any case. The court's valuation of $2,780,000.00, since it purported to be a going concern value, had to be a valuation before (not after) provision for payment of current liabilities, and hence exactly comparable with the cash bid.

Moreover and more important, the trustee misses our point that the cash bids never reached their maximum. (C.Br.45ff.). Both the bidders expressly stated that they had not reached their maximum. Instead of urging new bidders to enter the lists or even those cash bidders to give their top figure, the trustee warned that no cash bid would be accepted by major creditors. The effect of this, of course, was to knock in the head any impulse for bidders to bid. We do not know how high they would have gone. We do know that in a very short space of time they have jumped by small steps from $1,600,000.00 to $2,800,000.00 and had not reached the top. (ibid.).

The well-advertised refusal of major creditors to take *any* cash bid shows, of course, that their own valuation of the enterprise was much higher than the derisory figure put on it by the court. This is strongly reinforced by the fact that creditors who were entitled under the plan to get 100 cents on the dollar elected of their own free choice to take stock (II 878, 879.3, 987; III 91, 94). What this proves is either that the acceptances of the plan were not in good faith (as we assert); or that the real value of the enterprise was more than 100 cents on the dollar of creditors claim - i.e., that it was solvent (as we also assert); or both.

Trustee's brief p.50: the creditors committee's purported adverse report on the cash plan: – In defense of his assertion that cash bids did not supply a realistic alternative to the court's valuation in the alternate "internal" plan, the

trustee says: "The Creditors Committee had reported that it would not recommend a cash plan that did not provide for a maximum payment of at least 50¢ on the dollar for the unsecured creditors (II 652)" Not quite. The creditors committee's criticisms applied equally to either plan and was stated before either plan was formulated: "As a Creditors Committee, we do not feel that we could recommend any plan to the Court which did not provide for a minimum payment of at least fifty (50) cents on the dollar, *either* in cash, cash and securities or securities, which would be acceptable to the unsecured creditors." (II. 652, our emph.) It was rather the trustee's allies, the insider creditors, that rejected the cash plan, citations collected C.Br.47.

Trustee's brief, p. 53-4: 1961 tender of "Statement of Position": – The trustee says that the record contains "nothing to indicate that the (stockholders' creditor-claim) issue was ever brought to the attention of the court or any interested party in 1961, as Petitioner contends." Our Statement of Position (II, 1037) explicitly advancing this claim was served in March 1961. Although then rejected by the court, it was later filed nunc pro tunc by leave of court. Printed in the appendix infra, at A 2-7, are extracts from the district court record on the point: our service certificate dated March 24, 1961, showing service of our "Statement of Position"; also the 1963 Rule 60(a) petition to complete the record of 1961 tender, and the 1963 colloquy in open court in which the district judge, granting our petition, recited his recollection of the tender, precisely as stated C. Br. 14 n. 17. Certified photocopies of the original district court documents have been lodged here with the Clerk. Between the 1961 tender and 1963 formal filing, it was expressly referred to in June 1962 without contradiction as having been tendered "over a year ago" (II 367-8).

Trustee's brief, p. 62: class action:– The trustee says, "this is not the kind of class action permitted".– In the securities field, well-considered cases and the Advisory Committee on the Rules recognize that "a fraud perpetrated on numerous persons by the use of similar misrepresentations," as we charge is the case here, "may be an appealing situation for class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class." Advisory Committee's Note to new Rule 23. *Fischer v. Kletz*, 41 F.R.D. 377 (S.D.N.Y., 1966); *Oppenheimer v. F. J. Young & Co.*, 144 F.2d 387, 390 (CA 2, 1944).

We do not advance our claim as a class action under Rule 23, however, for our position is stronger. An essential feature of Chapter X is the protection by representative committees of the interests of scattered small security holders. 2 SEC, *Report on the Study and Investigation of . . . Reorganization Committees* 1-7, 495-7, 502-3 (1937). The technique of settling in principle the complex issues affecting alike all the public stockholders who bought in the manipulated market, by a representative claim (subject to proving up the damages claimable by individual victims after the principle is settled) reflects precisely one of the basic purposes of Chapter X.

Trustee's Brief Appendix A1-2: the trustee's budget of alleged inaccuracies:–

No.1 On the essential soundness and profitability of the company (C Br 5), see the trustee's own statement of this and of the reasons for the debacle which do not go to the essential soundness of the enterprise (I 260,271). Cf. the earnings reported even under retrenched reorganization conditions, Tr Br 44, downwardly distorted at that, C Br 47-50.

No.2 On stock options (C Br 5,62), the trustee does not deny the basic point that three successive plans he presented made him president and director with explicit or, later, implicit assurance of a long-term contract to be obtained from his beneficiaries. His denial that these deals included as icing on the cake explicit or, later, implicit assurances of substantial stock options will not stand in the face of the record citations in CBr 8,13, to which we add III 255; cf. 352-354, 52-53, 93, 197.

No. 3 On Committee charges of fraud against Merrill-Stevens, see our comment on TrBr 36, supra, p. 8.

No.4 On the locus of control, see record citations at C Br 8,12,25, 36-39.

No.5 As to Merrill-Stevens control, see No. 4 above. As to the thoroughness of his investigation of Merrill-Stevens, see the trustee's failure to permit discovery procedures to bring into the record incriminating documents we had located and identified and that he admitted he had never seen, citations at CBr 26. As to the proof of fraud against Shaffer-Spitzer, see his own explicit conclusions from the investigation so reluctantly undertaken, in which he took 2200 pages of testimony and 60 exhibits from 33 witnesses and concluded that the Caplan (Shaffer-Spitzer) mortgage was a fraudulent transfer (I 282) and that numerous actionable frauds were perpetrated by its principals (I 290,291, 291-2). As to Shaffer-Spitzer's concealment of their relation to Abrams, see the affidavits by Messrs Shaffer and Caplan (I 173-9) and the direct denial by Mr. Spitzer in

open court, infra App p 1, original lodged with the Clerk; and see the trustee's conclusions of misrepresentation to the court on this and other points (I 274-281, 288-9).

No.6 See No. 3 above. The allegation that Merrill Stevens was involved in the marketrigging is not an allegation that they sold stock in rigged market: they helped others to do so and it is immaterial whether they themselves did so.

The Shaffer-Spitzer Brief.

Shaffer-Spitzer present themselves and their predecessor Caplan as indenture trustees for "a group of plainly disclosed investors" (S-S Br 5) who have been amply investigated and have turned their pockets inside out (S-S Br 9 ff). Bluntly, this picture is a hoax.

Our principal brief did not anticipate an active appearance at this stage by Shaffer-Spitzer who filed no brief in the Court of Appeals and did not oppose certiorari. Since we did not anticipate their presence, our main brief deals more summarily with matters concerning them than is appropriate in the face of their broad denial of facts we detailed and their detailed recital and misrepresentation of facts out of context that serve only to distract.

The identities of the Shaffer-Spitzer group were elaborately hidden under several layers of cloaking. The real principals were Abrams, Shaffer, Erdman. They are identified in CBr 7 n.2,3,4. The instruments, however, did not name Abrams nor Shaffer nor Erdman (I 274; the text is set out at pp 23-53 of the record of the Fifth Circuit No. 17117 which was incorporated by stipulation in the present record and has been lodged with the Clerk). Caplan, the original trustee "at all times was a front for Shaffer" (I 275). Abrams' interest was hidden in part behind Gordon and in part under a corporate name, Bostwick Westbury (I 259, 276,277) and these interests were in turn hidden behind Kahn and Russo, Russo in turn behind Schwerin like a game of three card monte (I 277-8). Erdman's interests were hidden behind still other names (I 276).

The mortgage was itself a market-operator's fraud. This group, elaborately masked, were the financial advisors of the company, insiders who dominated the company to its harm, caused it to issue to them over 1,800,000 shares of stock illegally and float it fraudulently to the public at hundreds of thousands of dollars of profit to themselves (I 262,281, 286-291; II 1092) and rendered the company by their abuse incapable of obtaining financing from respectable sources (I 289) so that when it needed money (as a result of the Carib Queen explosion) on what insiders knew was the brink of bankruptcy (I 286) it could obtain it only from them.

The deal masqueraded as a mortgage just as the insiders masqueraded under front names as investors. In fact it was a market manipulation and a bankruptcy manipulation, that furnished short-term money for a long term need at grossly exorbitant terms, with a conversion privilege for equity profits in case of rescue but a mortgage form (on the only remaining working assets) to dominate the reorganization, if as seemed likely and as proved to be the case, there was to be one (I 273, 284-290). This is a classic manoeuvre, I SEC, *Report on the Study and Investigation of . . . Reorganization Committees* 160. This mortgage, the trustee correctly characterized as an abuse of fiduciary power (I 286-290).

Full relevant disclosure has still not been made. Not until a § 167 investigation made by the trustee with the aid of the SEC's expertise about stock manipulation were any of the facts brought home which lay behind misleading affidavits by Caplan and Shaffer (I 173-9) and a denial by Spitzer in open court (infra, App. 1) that Abrams, Shaffer and Erdman are the real principals as well as the history of their domination and exploitation of TMT by stock manipulation and their defrauding of public stockholders.

The trustee had to be goaded by our appeal and by the SEC's staff affidavits of corroboration before he would go beyond his friendly confidence in this group of experienced

confidence men. His investigation is not yet complete—he has still declined to investigate Merrill-Stevens' involvement in the same conspiracy, supra p. 8. As far as it went, however, it demonstrated misrepresentation of the identity of the principals, and their involvement in fiduciary abuses culminating in the mortgage.

Investigation of the facts is not enough. The trustee himself proposed appropriate remedies demanded by the equities: set-offs for profits made by the principals, suits against the principals (for the Wilmington fraud, but also for the Bellanca fraud and others), creditor treatment for the stockholders and disallowance of the mortgage claim or at least subordination to the stockholders as creditors by reason of the frauds. These are the trustee's recommendations (I 282, 286, 289,290,291,294; II 1092,1096). None of this has happened (except the Wilmington suit still pending). CBr 30-32,56.

There has never been the disclosure, required by the case law (CBr 32-6) of reasons why, after recommending these remedies on a carefully built record, the trustee once again has surrendered and gives the Shaffer-Spitzer group priority treatment over the defrauded creditors and other innocent general creditors.

As to the set-offs and suits, the situation is worse. Not only was there a failure to disclose reasons for not bringing the suits and for not asserting the set-offs, the trustee failed to disclose on the record to the stockholders or creditors or SEC that a secret understanding was actually made in 1962 to suppress the suits and waive the set-offs. This was disclosed as to the suits for the first time in 1965 (III 192; CBr 30) and as to set-offs in 1966, after the start of the present appeal, when a debenture claim of Shaffer's wife, Pauline Golding was recommended for allowance on the express ground of this concealed agreement.

The disclosure that such abandonment of defenses against claims by individual Shaffer-Spitzer people was also "settled in the plan of reorganization" (III,192) took place in a

district court pleading filed by the trustee stating as reason for not defending against the Golding claim:

> "It was *determined by the trustee, and approved by this court,* in 1962 when the present Internal Plan of Reorganization was being considered, approved, accepted by the creditors, and confirmed that there would be *no actions brought* against Arthur Shaffer or Pauline Golding and certain others as a result of apparent irregularities that may have occurred in the issuance of TMT stock" (Our emph.)

The record documents on this disclosure appear infra, App. A 7 ff., certified originals lodged here with the Clerk.

Shaffer-Spitzer, in concluding their brief, assert the standard case law that set-offs against cestuis are not available against the mortgage itself. But this cited case law (S-S Br p. 32-3) deals with innocent cestuis, carefully distinguished in the very passage they quoted from *Dickerman v. Northern Trust Co.*, 176 U.S. 181, "so far at least as they were innocent holders". It can have no application to conspirators for whom the indenture trustee is a tool as the reorganization trustee found here.

Thirty years ago the SEC, in the monumental report that led to the procedural reforms embodied in Chapter X, pointed out how easy it is for those who dominate a bad reorganization to make it look good enough for a trusting court to approve:

> "Outwardly reorganizations may appear to be expeditious, economical, fair, and honest. Often, how-

ever, those characteristics will only be illusions. Reorganizers will merely have dressed the procedure in familiar and respectable garb", Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees,* Part I, p5 (1937).

Respectfully submitted,

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November 6, 1967

EXCERPT FROM TRANSCRIPT OF HEARING HELD JANUARY 5, 1959, p. 39-40.

[District Court Caption and Style and Clerk's Certificate Omitted].

THE COURT: Are there any questions of these gentlemen?

MR. HYMAN: Your Honor, not knowing who the Florida Towing Company is, I would like to ask who Mr. Caplan is Trustee for?

I think it is important to the general creditors to know who the people are who are putting up the money.

MR. PETERS: May we have Mr. Spitzer reply to that?

MR. SPITZER: It is a group of New York industrialists, all of whom are in business. One is a member of the New York Stock Exchange; one is the head of a business that is listed on the New York Stock Exchange.

They are in a variety of businesses and are men who have formed a business to put up this money, and none of whom are in a business engaged in competition or that seeks to serve TMT.

MR. HYMAN: Is there a Mr. Joe Abrams interested in or who is a part of that group?

MR. SPITZER: There is no Mr. Joe Abrams in our group. He has an interest, I believe, in – No, there is not. No.

MR. HYMAN: The reason I ask is that we ran into Mr. Abrams and his family to such an extent in transactions involving the transfer of stock and the putting of stock on the market and the transfer of stock to Mr. Abrams and some of his relatives and the purchase of land at a valuation of perhaps $1.00 when the stock was actually $2.00 or $3.00 in the market, and quite some amazing and fantastic transactions, from our point of view.

MR. SPITZER: Mr. Hyman, there is a list of each person in this group, with the amount of each man's contribution, which has been submitted to the Trustee, and the Court. I am sure it is on file.

MR. ANDERSON: It is on file.

* * *

CERTIFICATE OF SERVICE ACCOMPANYING "PETITION OF PROTECTIVE COMMITTEE * * * TO FILE STATEMENT OF POSITION" AND "STATEMENT OF POSITION" [District Court Caption and Style and Clerk's Certificate and (April 16, 1963) Filing Stamp Omitted]

I hereby certify that a copy of the foregoing petition of Protective Committee For Independent Stockholders of TMT Trailer Ferry, Inc., for Leave to File Statement of Position, and a copy of Statement of Position of Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. were mailed on March 24, 1961 to each of the parties listed below:

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/s/ IRWIN L. LANGBEIN

EXCERPT FROM TRANSCRIPT OF HEARING HELD APRIL 15, 1963, p. 5-8

[District Court Caption and Style and Clerk's Certificate Omitted]

MR. LANGBEIN: Further on TMT, Your Honor, Mr. Simmons arranged with me to bring on without notice a matter on which he was kind enough to give me his usual cooperation. He simply wanted me to present the matter to you and abide by your Order.

This relates to the appeal record that we are making up for the stockholders' appeal.

I wanted to put into that record something to indicate the fact that the rescission claim which is in litigation in the appeal was made a long, long time back and wasn't a brand new idea of ours.

THE COURT: What is that?

MR. LANGBEIN: The claim for rescission is that the stockholders could be treated as creditors.

You recall that the Court ruled —

THE COURT: Yes, it was suggested. You can put that in if you want to. Nothing that I know of was ever undertaken by any of the stockholders.

In that case I suggested when it was brought up, I think at least a year and a half or two years ago, I stated that there was nothing that the Court could do, that they had the right to proceed or not proceed as they saw fit.

MR. LANGBEIN: I don't recall that.

THE COURT: What I say is manifestly true. If they wanted to rescind their subscriptions they had a right to do so. I couldn't prevent or encourage them but they were free to make application for rescission with the permission of this Court or in the proceedings itself, as they saw fit.

MR. LANGBEIN: I think the Court is referring to an Order issued in April of 1959 in which we applied for leave to file a statement of position. At that time it was denied.

THE COURT: I said that every stockholder had the right to proceed without the control of the Court.

MR. LANGBEIN: I think the record is silent on that particular remark.

THE COURT: The record may be silent. I remember discussing it with you and Mr. Simmons at some length.

MR. LANGBEIN: I am not trying to make a retroactive record.

THE COURT: Let the record show what I have stated here, which is quite correct.

MR. LANGBEIN: What I did want to do was establish for the purposes of the record whether or not we made formal application in time and that we had raised the question somewhat earlier.

THE COURT: You had raised the question and even today if the stockholders had a right of decision this Court would welcome them as creditors if they were entitled to become creditors.

I do think there would be some questions about the matter that couldn't be passed on.

MR. LANGBEIN: So do I, very serious legal questions.

THE COURT: I think the matter was fully discussed at least a year and a half ago or two years ago.

MR. LANGBEIN: Mr. Simmons couldn't stipulate on matters out of the record without the Court's permission. I thought that rather than have anybody stipulate, what we would do was ask the Court now for leave to physically file the petition in which we raised that question and then it would speak for itself.

If the Court denied us the right at that time –

THE COURT: I denied the right at that time. I think it should be part of the record and you have permission to make it part of the record.

MR. LANGBEIN: That is all I want.

MR. LANGBEIN: I will file it as an exhibit.

THE COURT: If the 5th Circuit decides you have the right to become creditors, I have no objection.

MR. LANGBEIN: I will file it with the Court as if it were a rejected exhibit, then?

THE COURT: That's right.

RENEWAL OF PETITION FOR LEAVE TO FILE "STATEMENT OF POSITION"

[District Court Caption and Style and Clerk's Certificate and Filing Stamp Omitted]

On or about March 24. 1961, The Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. prepared and served upon all interested parties a document in this case entitled "Petition of Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. for *Leave to File* a Statement of Position" together with a copy of such Statement of Position; and a certificate of service. The Statement, among other things, asserted rights of rescission on behalf of all non-management stockholders.

These documents were however not actually filed with the Court, in deference to an oral ruling made in open court in April 1961, denying such leave. That ruling was embodied in a formal order dated April 26, 1961, in which the petition was "denied, without prejudice, to such right as Petitioner may have to raise the issues stated in the Petition at proper stages in these proceedings".

The Committee has asserted these recission rights at later stages, e.g., in the Committee's "Suggestions for formulation of a plan of reorganization" filed March 30, 1962. In the Committee's "Proof of Claim for Rescission" filed June 20, 1962, the Committee referred back to its making of the same contention in the "Statement". For purposes of the appeals which the Committee now has pending to the Court of Appeals for the Fifth Circuit from this Court's orders finding the debtor insolvent and confirming a plan of reorganization, the Committee deems it appropriate to confirm that it asserted rights of rescission on behalf of all independent stockholders as early as the "Statement" of March 1961, and that it then notified all parties of such assertion.

WHEREFORE the Committee prays leave to physically incorporate in the record the original petition and "Statement" referred to, together with the certificate of service thereof.

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* * *

PETITION FOR DISALLOWANCE OF CLAIM OF PAULINE GOLDING

[District Court Caption and Style and Clerk's Certificate and (May 2, 1966) Filing Stamp Omitted]

Irma S. Mason, a party to the proceeding, objects to the issuance by the trustee of stock in the reorganized company to claimant Pauline Golding (No. D-48) and petitions for the cancellation of any stock so issued and for vacation of the Order of this Court dated March 30, 1966 approving the issuance of such stock, and for an order directing the trustee to make a full investigation of the circumstances of the alleged issuance to Pauline Golding of the purported obligations on which her claim is based, and the date at which and the consideration for which such purported obligations were issued. In support of this petition she respectfully shows the Court the following, on information and belief, the source of such information being primarily, as indicated, the trustee's Report of Investiga-

tion and sworn testimony and documents produced in the trustee's investigation (for convenience of reference certain documents are referred to herein as they appear in the record on appeal in the Court of Appeals; the trustee's Report may be found in the printed record in No. 18475 at pages 255 ff.):

1. By a letter dated November 17, 1965 and notarized November 19, 1965, Pauline Golding claims to be the owner of $115,000 in principal amount of 6% convertible notes due August 1, 1958, of TMT Trailer Ferry, Inc., all dated as of April 22, 1957, registered in her name.

2. By petition dated March 11, 1966, the trustee requested approval of the issuance of stock to Pauline Golding as a debenture claimant in the amount of $115,000 in addition to some 50 other claimants. The claims of the 50 other claimants initially totalled $74,300 but the trustee's petition requested approval for allowing these claims in the adjusted amount of $80,600 in addition to Pauline Golding's claim of $115,000. The trustee's petition was brought on for hearing on March 25, 1966.

3. By verified objections dated March 24, 1966, and by objections orally heard at the hearing on March 25, 1966, petitioner objected to the issuance of such stock to Pauline Golding.

4. By order dated March 30, 1966, the Court approved the issuance of such stock and denied the objections, without prejudice however to the filing of a Petition or separate suit seeking relief on the subject.

A. *The bonds were never validly issued.*

5. Pauline Golding is the wife of Arthur Shaffer (Tr. Rep. par. 18) who was a financial advisor of TMT (Tr. Rep. par. 13, 18, 28, B, 56, 57) and who breached the fiduciary obligations of his position (Tr. Rep. par. 57 and Recommendation 3). The trustee conducted an investigation of the activities of Arthur Shaffer. Petitioner attended the hearing at which Mr. Shaffer testified concerning his own and his wife's transactions in TMT and produced financial records.

The trustee's Report of Investigation also indicates that Shaffer's disclosure of all TMT transactions clearly included therein those of his wife Pauline Golding (Tr. Rep. par. 44, cf. 18, 57). The trustee's Report, which is confirmed by petitioner's understanding of Shaffer's testimony, does not reflect the acquisition of any notes not thereafter converted to stock and sold by the Shaffers. Even if there were no other circumstances casting doubt on the validity of the now-proffered notes, this would be sufficient to require an investigation by the trustee of the date when and the consideration for which and the circumstances under which the said purported notes were allegedly issued to Pauline Golding. These doubts are confirmed by the records of the debtor.

6. The purported notes in question are registered notes. This is expressly stated in Pauline Golding's affidavit. Examination of a copy of one of the purported notes shows express provision that the company may treat the record owner on the records of the company as the absolute owner for receiving payment and for all other purposes. But the records of the company did not show Pauline Golding as the owner, nor even the issuance of such amount of notes to anyone. They show a maximum of $79,000 worth, all of which are accounted for by the 50 other claimants whose claims are approved by the trustee.

7. The present proceedings were initiated June 27, 1957 (No. 18475, p. 21). In a verified petition of the debtor's subsidiary Trans-Caribbean Motor Transport, Inc., there is incorporated a consolidated financial statement as at June 30, 1957. That balance sheet shows under long-term liabilities of the debtor outstanding 6% Series "D" convertible notes, due August 1, 1958, as being $79,000 in amount. This manifestly does not include the $115,000 of purported notes claimed by Pauline Golding. (Record No. 19996, p. 440 at 444.2).

8. In a consolidated financial statement issued by the debtor with a notice of meeting dated September 20, 1957,

the same figure of $79,000 is given for the 6% Series "D" convertible notes due August 1, 1958, outstanding as at July 1, 1957.

9. A trial balance of the debtor's books as of October 31, 1957 shows the then outstanding such Series "D" notes in the same amount.

10. It is obvious that the notes purportedly held by Pauline Golding in the amount of $115,000 were not and cannot be included in the notes shown by the debtor's books to be outstanding, which did not exceed $79,000. Mr. Shaffer's review in 1960 of his transactions and Pauline Golding's did not assert the existence of such notes. The trustee's list of approved claims as at December 31, 1959 shows $74,300, well within the recorded amount (No. 18475, p. 358).

B. *If ever actually issued, the notes in question were issued in connection with fraudulent transactions and are invalid.*

11. The claim does not identify the transaction in which the notes held by the claimant were isssued. It is noted, however, that these notes bear the printed date as of April 22, 1957 and were necessarily issued later than that date. This is after the Carib Queen had broken down returning from its maiden voyage to Europe (Tr. Rep. par. 28).

12. The purported date of execution, as of April 22, 1957, was coincidental with a series of meetings held in New York in which the conspiracy group of Shaffer and Abrams and Erdman along with Rath and Gitlin were attempting to arrange for a transfer of control of the enterprise (Tr. Rep. par. 29).

13. The purported date of execution was also coincidental with other actions of the conspirators: it is known that on May 15, 1957, stock was issued for a price substantially below the then market to the group of Shaffer and Abrams, and of this stock Shaffer handled 150,000 shares, 115,000 of which went to his wife Pauline Golding (Tr. Rep. par. 30). It is probable in the light of the known

operations of this group that the coincidence of 115,000 shares of stock with the $115,000 of alleged notes is a significant one.

C. *Not only Arthur Shaffer but Pauline Golding personally was involved in a large number of improper transactions clearly indicating that she was privy to the frauds committed by the conspirators against the debtor and its public security holders.*

14. It is known that Pauline Golding was affiliated with the conspirator Abrams in a number of matters other than TMT as well as in TMT matters (affidavit of Sameth, No. 18475, pp. 226-227).

15. Shaffer speculated extensively in TMT stock and made large profits. A major part of these profits of over $244,000 was on stock acquired in his wife's name (Tr. Rep. par. 44).

16. These transactions involved stock issued to Pauline Golding without appropriate registration or other filing under the Securities Acts, and illegally sold by her in violation of the Securities Acts and in connivance with TMT's management which deliberately and improperly caused the stock to be issued without an investment legend, thereby defrauding purchasers of the stock who bought in the belief that it had been validly issued. Letters from the company to Manufacturers Trust, for example, directed the issuance of 165,000 shares of stock to Pauline Golding without an investment legend, July 27, 1956. Several other such letters exist.

17. On this single transaction Pauline Golding realized large improper profits at the expense of the stockholders; the stock and the bonds converted to stock cost her $1 per share (together with free bonus stock) at a time when the market for the stock was more than $3 per share and it was sold shortly on a continued high market (Tr. Rep. par. 13, 14, 17, 18, 19, 44).

18. The trustee's Report expressly comments on the ownership or control of large blocks of stock in the name of Shaffer and Abrams "or that of a wife or controlled

corporation" as indicative of the high degree of control in the affairs of TMT by the conspirators Shaffer and Abrams (Tr. Rep. par. 57).

19. The trustee's Report expressly comments that transactions such as those practiced by Pauline Golding of taking stock for less than the market price and selling it without registration injured TMT by decreasing its opportunity of obtaining reputable financing (Tr. Rep. par. 57).

20. The trustee's Report shows that about July 1956 Pauline Golding converted $150,000 of the $400,000 6% convertible notes issued in December 1955 and demanded and received advance interest and an additional 15,000 shares as a bonus for the conversion (Tr. Rep. par. 18). The stock was promptly dumped on the market (Tr. Rep. par 18 and 44). Eric Rath testified that this bonus was given to Pauline Golding because Shaffer and Abrams compelled TMT to pay it.

21. Like Alex Caplan who was Shaffer's front in the mortgage transaction (Tr. Rep. par. 32), Pauline Golding was also involved in Pierce Governor-TMT stock switches with Abrams (testimony of Arthur Shaffer). This is a characteristic Abrams manipulative device of which other examples are present in the record (Tr. Rep. par. 15, 16, 19, 38).

D. *Pauline Golding received improper profits at the expense of the debtor and its public security holders and is therefore subject to set-offs in excess of the amount of her claim.*

22. We have already noted, in paragraph 20, that 15,000 shares of TMT stock were issued to Pauline Golding as an improper bonus by reason of duress exerted by Shaffer and Abrams and were dumped on the public market by her in violation of securities laws. In paragraph 15, (Tr. Rep. par. 44) we have noted a minimum of $244,000 of profits received by Shaffer and Pauline Golding on improper trading in TMT securities. We have also noted in paragraph 17 that on a single such improper transaction Pauline Golding indi-

vidually realized large improper profits. All of these facts were ascertained by the trustee in his investigation and reported in his Report.

23. We have also noted in paragraph 19, as has the trustee, the general and sweeping injury to the enterprise of the type of financing in which Pauline Golding along with Shaffer and Abrams involved the debtor.

24. Thus, for example, the trustee expressly noted that the "business was wrecked by gross mismanagement, by unsound expansion through the sale of securities in disregard of the protective provisions of the Securities Act of 1933", par. 8; that "the rise and fall of TMT can be told in the light of circumstances and persons involved in its stock transactions", par. 10; and "when the insider group took stock for less than the market price and sold it without registration, they lessened TMT's chances of interesting a reputable financial institution in providing financing", par. 57. We have already seen that Pauline Golding was not only privy to this course of conduct, but personally participated in it and profited from it.

25. The trustee expressly and correctly recommended as to Shaffer, Abrams and Erdman that "their claims should be reduced by the profits they have made on sales of TMT stock which they acquired for private investment purposes, but which they sold in violation of the law at great profit to themselves" par. 58. He added more generally "A fraud was perpetrated upon TMT by those who obtained from it unregistered stock with no intention of holding it for investment" par. 60. We have seen that that is the case as to Pauline Golding. The trustee added further: "If facts come to light which indicate that others profited by such stock sales in violation of the law, it is the opinion of the trustee that they should likewise be required to account to the company for any profits realized" Par. 62. This analysis by the trustee is correct and is clearly applicable to Pauline Golding. She received large blocks of unregistered securities at prices under the market, issued

in part as a result of her husband's duress and as a result of the large control exercised by her husband and by Abrams with whom she was associated not only in this but in other matters, and she promptly resold those securities in a public speculative market, again without registration. On these transactions she realized large profits to the injury of both TMT and its public security holders.

E. *It was not previously known that the trustee proposed to allow Pauline Golding's claim.*

26. We have already noted in part A that Shaffer's testimony and the trustee's Report of his investigation did not disclose the existence of the purported notes claimed by Pauline Golding and that financial statements of the debtor negatived their existence.

27. Even if such purported notes had been known to exist, the trustee's explicit statements of disapproval of the transactions in which the Shaffers were involved and his explicit recommendation that persons in Pauline Golding's position be made to account left no room to suppose that the trustee would recommend allowance of any such claim by her.

28. When the trustee indicated that debenture holders would be allowed to share, this could only be understood as meaning that valid holders would so share. Neither then nor elsewhere until the trustee's petition of March 11, 1966, so far as petitioner is aware, was there any indication that Pauline Golding held $115,000 of such notes which the trustee was prepared to recognize in addition to the approximately $79,000 worth known to be held by others.

29. Her alleged notes were manifestly not included in the $74,300 of debenture claims reported by the trustee's auditor, February 29, 1960, as at December 31, 1959 (No. 18475 p. 358).

30. Her alleged notes were not included in the $47,100 of acceptance by debenture claimants listed by the trustee April 19, 1965 (NR 318).

31. No claim was filed by her within 60 days after January 15, 1959, the last day for filing debenture claims under the first reorganization plan (No. 18475, p. 47, 137). No claim was filed by her on or before August 1, 1962, the last day for filing debenture claims under the second reorganization plan (No. 19996, R 381). No claim was filed by her on or before April 7, 1965, the last day for filing creditor's claims "including debenture bondholders" under the present plan (No. 22652, NR 270). Under these circumstances it could not be assumed that the trustee had any intention of allowing such a claim.

32. It appears from a letter from the trustee's counsel, dated March 28, 1966, that prior to November 17, 1965 no claim had ever been filed for Pauline Golding.

33. The trustee has indicated that he construes the plan of reorganization as protecting the interests of all debenture bond holders whether or not a formal claim is filed. This is clearly contrary to the unambiguous terms of the court's order fixing a time in which creditors claims and claims based on securities must be filed (Order, February 3, 1958, No. 18475 p. 46).

34. We submit therefore that the claim is out of time and should be rejected on the present record. Although the claim is out of time we are not arguing that on an appropriate showing the time cannot be or should not be extended. On the contrary, we believe that appropriate extensions of time should be liberally made wherever justice will thereby be served. Nevertheless, we submit that such an extension should not be made by mere implication without any affirmative showing of equity. The burden is necessarily on the claimant to request and show cause for any such extension, and only if and when she makes such a showing can appropriate consideration be given to the propriety of the extension and the merits of the claim.

35. From these facts of record, it appears that:

(a) Pauline Golding was in privity with the prime conspirators Abrams and Shaffer and therefore her claim should be disallowed or at least subordinated to claims of stockholders injured by the conspirators' actions;

(b) by her own transactions she directly injured TMT and injured public stockholders by improper acquisitions and illegal sales of securities and her claim should therefore either be disallowed or at least subordinated to those of stockholders;

(c) by illegal and fraudulent transactions in which she directly participated Pauline Golding has realized large profits in excess of the amount of her claim and therefore as a minimum these profits should be set-off against her claim and her claim should therefore be denied.

We further submit that the above facts showing ample basis for disallowance of the present claim are derived from an investigation primarily directed to other issues. It is therefore certain that the trustee had and has a duty, as a minimum, to pursue a full and adequate investigation of all of the relations of Pauline Golding with TMT.

Respectfully submitted,

/s/ Irwin L. Langbein
Attorney for Petitioner
Irma S. Mason
301 Citizens Building
West Palm Beach, Florida

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss:

IRMA S. MASON, being by the undersigned officer first duly sworn, upon her oath, says that she is the Petitioner who makes the foregoing Petition for Disallowance of Claim of Pauline Golding (D-48) and that it is true except as to those matters stated on information and belief, which statements she believes to be true.

/s/ Irma S. Mason

Sworn to and subscribed before
me this April 20, 1966

/s/ David Lench
Notary Public, State of New York [SEAL]

MOTION OF TRUSTEE TO DISMISS PETITION FOR DISALLOWANCE OF CLAIM OF PAULINE GOLDING

[District Court Caption and Style and Clerk's Certificate and (May 9, 1966) Filing Stamp Omitted]

The Trustee, C. GORDON ANDERSON, by his undersigned counsel moves to dismiss the PETITION FOR DISALLOWANCE OF CLAIM OF PAULINE GOLDING filed on behalf of one Irma S. Mason on the following grounds:–

1. Petitioner is a stockholder of the debtor and as such has no standing to object to the claim.

2. Unsecured creditors of the debtor are the only parties whose interests are involved in the allowance of the Pauline Golding claim, and no such creditor has filed any objection thereto although notice of the hearing held on March 25, 1966, for consideration of the claim was sent to all parties entitled to notice of proceedings herein.

3. The disallowance of the claim in toto would not result in the solvency of the debtor, and would therefore be of no benefit to Petitioner or other stockholders.

4. The objections to the claim based upon failure to file a formal claim within the times set for filing such claims are without merit, this court having by its order of March 30, 1966, approved the Trustee's method of recognizing the holders of debenture bonds as claimants.

5. All of the objections to the claim are based upon facts disclosed and fully reported by the Trustee in his Report of Investigation filed herein on July 1, 1960. It was determined by the trustee, and approved by this court, in 1962 when the present Internal Plan of Reorgani-

zation was being considered, approved, accepted by the creditors, and confirmed that there would be no actions brought against Arthur Shaeffer or Pauline Golding and certain others as a result of apparent irregularities that may have occurred in the issuance of TMT stock. It was at that time and is still the opinion of the Trustee and of his counsel that benefits to be derived from such litigation are remote and do not warrant the trouble and expense of prosecution. This decision has been reached after careful evaluation of all factors involved.

6. The Plan of Reorganization has been substantially consummated and it would not benefit the reorganized company to engage in litigation at the request of one of the former stockholders.

DATED this 9th day of May, 1966.

/s/ William P. Simmons, Jr.
Shutts & Bowen
First National Bank Building
Miami, Florida 33131
Attorneys for C. Gordon
Anderson, Trustee

ORDER ON PETITION RE CLAIM OF PAULINE GOLDING

[District Court Caption and Style and Clerk's Certificate Omitted: No Clerk's Filing Stamp Shown]

Upon consideration in open court of the PETITION FOR DISALLOWANCE OF CLAIM OF PAULINE GOLDING, filed by counsel for Irma S. Mason, and it appearing that the issues raised in said petition should not be considered by this Court until after the United States Court of Appeals for the Fifth Circuit has decided pending appeals that have been taken by The Protective Committee for Independent Stockholders of TMT Trailer Ferry Inc., it is

ORDERED, ADJUDGED and DECREED that further consideration of the said petition of Irma S. Mason and of the motions which have been filed by the Trustee and by counsel for Pauline Golding with respect thereto are hereby deferred for further consideration until after the appellate court has acted on the appeals now pending before it from various orders of this court.

DONE and ORDERED at Miami, Dade County, Florida, this 20th day of May, 1966.

/s/ David W. Dyn
Chief, United States District Judge

Letterhead of Securities and Exchange Commission

VIA AIRMAIL May 25, 1966

Edward W. Wadsworth, Esquire
Clerk, United States Court of Appeals
for the Fifth Circuit
Louisiana Wild Life & Fisheries Building
400 Royal Street
New Orleans, Louisiana 70130

Re: *The Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. C. Gordon Anderson, Trustee,* (C.A. 5, No. 22,652)

Dear Mr. Wadsworth:

We have recently received from the Clerk of the District Court in Miami, Florida, a pleading filed on behalf of the Chapter X Trustee of TMT Trailer Ferry, Inc., in which the Trustee, apparently for the first time, makes the following disclosure which appears relevant to issues in the above-captioned appeal that was argued before a panel of the Court on March 16, 1966:

> "It was determined by the Trustee, and approved by this court, in 1962 when the present Internal Plan of Reorganization was being considered, approved, accepted by the creditors, and confirmed that there would be no actions brought against Arthur Shaeffer or Pauline Golding and certain others as a result of apparent irregularities that may have occurred in the issuance of TMT stock."

A copy of the pleading, in paragraph 5 of which this sentence occurs, is enclosed.

In briefing and in argument in this Court, this Commission and the appellant Stockholders' Committee contended that there had been inadequate hearings on matters of importance to the stockholders throughout the reorganization proceeding. This contention was strongly disputed by the Trustee. The above quotation shows that an important agreement not to sue was given to Pauline Golding by the Trustee in 1962 without, as far as we are able to determine from the record, any disclosure of that fact until now. Furthermore, the Trustee apparently construes this agreement as one to allow as an unsecured claim the $115,000 face amount of debentures she allegedly holds. notwithstanding any defenses or offsets which the Trustee might otherwise be entitled to assert.

Pauline Golding is the wife of Arthur Shaffer, who is the principal participant in the Caplan mortgage claim discussed in the briefs and in oral argument. The determination by the Trustee and any approval by the Court of an agreement not to sue Pauline Golding appears to have been made *in camera* in 1962, presumably at the same time it was determined that the Caplan mortgage would be settled. In briefs and oral argument in the pending appeal the Commission and the Committee have contended that the Caplan mortgage settlement gave too much away and it now appears that even more was given away than the securities holders were advised. This emphasizes the contention made on the

appeal that there should have been a hearing at which proponents for the settlement would have had to have made a showing to justify it.

We believe that the Court would wish to be informed of this development. We would appreciate your advising us whether a formal motion should be filed to bring this matter to the Court's attention or whether this letter might serve the purpose. Copies of this letter and of the attached enclosure are being sent to all parties to the appeal.

Sincerely,

/s/ David Ferber
Solicitor

Enclosure

Letterhead of United States Court of Appeals, Fifth Circuit

May 27, 1966

Honorable David Ferber
Solicitor
Securities and Exchange Commission
Washington, D.C. 20549

Re: *The Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. C. Gordon Anderson, Trustee (C.A. 5, No. 22,652).*

Dear Mr. Ferber:

Your letter of May 25 has been called to the attention of the Court and, in response to the last paragraph of your letter, I would advise that no formal motion is needed to bring this matter to the Court's attention. The letter is suf-

ficient for that purpose, unless further information is hereafter requested.

Sincerely yours,

/s/ Edward W. Wadsworth
Clerk.

cc: To All Parties to the Appeal.

Letterhead of Shutts & Bowen

May 27, 1966

Mr. Edward W. Wadsworth, Clerk
United States Court of Appeals
for the Fifth Circuit
400 Royal Street
New Orleans, Louisiana 70130

Re: The Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. C. Gordon Anderson, Trustee, (C.A. 5, No, 22,652)

Dear Mr. Wadsworth:

We have received a copy of a letter addressed to you regarding this case dated May 25, 1966 and signed by David Ferber, Solicitor for the Securities and Exchange Commission. As attorneys for the Appellee, the Trustee in reorganization, we object strenuously to Mr. Ferber's letter or any of its contents being brought to the attention of the court in connection with this appeal.

The case was argued several months ago and the record is closed insofar as the issues are concerned. It is not proper for the court to consider facts not in the record, especially where they concern matters that have occurred *since* the completion of the record and even since the argument of the case.

Mr. Ferber's letter grossly misrepresents the effect and intent of pleadings filed subsequent to the argument of the

case on appeal, and we do not intend to argue the matters presented in the letter. We earnestly trust that you will return the entire matter to Mr. Ferber and advise him that the court cannot consider it.

Yours very truly,

William P. Simmons, Jr.
Shutts & Bowen
Attorneys for C. Gordon
Anderson, Trustee

cc: Other counsel of record in the appeal.

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IN THE SUPREME COURT OF THE UNITED STATES

October Term 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER, FERRY, INC.,

Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,

Respondent.

PETITION OF RESPONDENT FOR REHEARING

William P. Simmons, Jr.,
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida 33131
Attorneys for Respondent

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1967

No. 38

PROTECTIVE COMMITTEE FOR INDEPENDENT STOCKHOLDERS OF TMT TRAILER, FERRY, INC.,

Petitioner,

vs.

C. GORDON ANDERSON, TRUSTEE,

Respondent.

PETITION OF RESPONDENT FOR REHEARING

The Respondent, C. GORDON ANDERSON, TRUSTEE, respectfully petitions the court for a rehearing of the issues determined in the opinion of the court entered herein on March 25, 1968.

The opinion of the court does not deal with any substantial Federal question of statutory construction but is concerned only with the court's re-evaluation of a large volume of evidence and circumstances bearing on whether two large claims should have been compromised and whether the debtor was insolvent. In analyzing the evi-

dence to reach the conclusion that the trial judge had decided the issues erroneously, certain material factors were overlooked and certain evidence was apparently not considered.

THE COMPROMISES OF THE CAPLAN MORTGAGE AND MERRILL-STEVENS CLAIMS

1. These compromises were set aside without the court giving any weight to the fact that they had the complete blessing of the only real parties in interest—the creditors. It was a committee representing the unsecured creditors who first proposed the compromises. No common creditor objected to the compromises, and the creditors on two occasions accepted by overwhelming vote the plan of reorganization in which the compromises were an integral part. The opinion of the court brushes this argument aside (page 18) with the statement that there had been inadequate investigation of objections to the claims and insufficient explanation given of the basis for approving the compromises. Entirely overlooked is the fact that **all creditors concerned were represented by counsel** who, it must be assumed, were aware of the well documented objections to the claims and were competent to advise their clients with respect to their merits and whether the compromises were fair and equitable under all the circumstances involved. Compromises agreed upon by all parties concerned, especially when represented by counsel, should be approved. The ends of justice are served when protracted litigation can be brought to an end by compromise, regardless of the possible uncertain merits of the contentions of the parties.

2. The court incorrectly **assumed** that by litigating the objections to the Caplan mortgage and Merrill-Stevens claims the outcome might contribute to a finding that the debtor was solvent and that therefore the stockholders would be entitled to participate in the reorganized company. The opinion stated (page 36) that "it is possible . . . the company will be found not to be insolvent," but we submit the record shows clearly that if the two claims were disallowed **in toto** the debtor would remain insolvent. We will discuss this in detail below under our argument on the insolvency issue.

THE INSOLVENCY ISSUE

1. The district court's finding of insolvency was set aside because the lower court did not have before it evidence and testimony relating to the future problems and prospects of the company. We respectfully submit that this assumption is not accurate and is not sustained by the record.

The two expert witnesses at the first valuation hearings held in 1962 gave consideration to future problems and prospects of TMT in making their estimates of going concern value. The Trustee's witness, Heusen, considered among other factors the problems of vessel replacement, additional capital to provide such replacement, the dwindling tax loss benefits, and future competition. (II 127-129)* He took those matters into account in arriving at a present going concern value based on the accurate records of past operations.

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*Refers to mimeographed transcript record of appeals. II is 5th Circuit record in Case #19,996. III is 5th Circuit record in Case #22,652.

The witness for the Stockholders Committee, Morgan, took into account in his valuation the expanding Puerto Rican economy, possible increase in TMT's share of the growing market, and elimination of reorganization expenses. (II 240-250) Considering these factors, he arrived at a going concern value of $4,519,500. (II 248)

The second valuation hearing held in January 1965, (III 120-212) includes lengthy discussions of existing factors affecting TMT's Puerto Rican trade which would necessarily have a direct bearing on future earnings of the company. These include the actions of competitors, the rate proceedings before the Maritime Commission, the need to replace the existing vessels and new financing required for such replacement. It is apparent from the testimony at this hearing that the Trustee presented to the court **all available information** on the future prospects of the company.

It is true, as the opinion of the court points out (page 31) that no projection of future revenues, expenses or income was prepared but such failure was thoroughly and adequately explained. The business manager for the Trustee was asked if he could estimate what TMT's earnings might be after reorganization. (III 142) His reply was that you could not tell at the time what vessels would be operating and, considering other uncertain factors, such an estimate would be most difficult and very indefinite. He explained that the cost of new vessels and their method of financing were matters that the Trustee had not gone into thoroughly because they were considered problems to be solved after reorganization by the new owners. (III -145)

It was on the basis of such testimony that the district court refused to require estimates to be made of future income which would be speculative and unreliable, and decided that the most reliable basis for determining going concern value were projections based on present conditions and past experience. Such determination by the trial judge is entirely consistent with the opinion of this court in **Consolidated Rock Products Co. v. DuBois**, 312 U.S. 510 since the past earnings record was found under the circumstances to be more reliable than estimates based on uncertain future conditions.

In summary, the district court had before it a good picture of the future problems and prospects of TMT but they were too uncertain, standing alone, to form the basis for reliable estimates of future earnings. There is nothing in the record to indicate that reliable and accurate future projections of earnings could be made in TMT's situation.

2. There is no basis in the record for the court's assumption that further valuation hearings could possibly result in a finding that TMT is solvent. In the absence of such possibility, the use of an erroneous method of arriving at TMT's going concern value is harmless error.

Claims against the debtor totaled $5,477,370.05. The strict priority rule requires payment of interest on claims before stockholders have any equity, as we point out on page 50 of our brief on the merits. The reorganization proceedings began in June 1957, and more than ten years interest (more than 60% at a 6% rate) will have to be added to the creditors' equity before stockholders can be considered. This would add more than three million dollars to the claims. There is nothing in the record to indicate

that a re-valuation of the debtor could possibly produce a going concern value that would exceed the amount of the claims with interest included. The most optimistic figure in the record of going concern value, that of the witness Morgan for the Stockholders Committee, is $4,519,500 and, of course, falls far short of the full amount of claims when interest on them is considered.

If the full amount of the Caplan mortgage and Merrill-Stevens claims, which total about $1,958,000 is eliminated from consideration, it is apparent that the debtor would remain insolvent as the district judge found.

We therefore respectfully suggest that the court has not fully considered that a finding of solvency under the facts and circumstances here is so remote and entirely unlikely that any error in the method of arriving at the debtor's going concern value is a harmless one.

CONCLUSION

For the reasons stated above, it is respectfully submitted that a rehearing should be granted and the orders and opinions of the lower courts affirmed.

WILLIAM P. SIMMONS, JR.,
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida 33131
Attorneys for the Respondent

Dated: April 18, 1968

CERTIFICATE OF COUNSEL

The undersigned, as attorney for the respondent herein, hereby certifies that the foregoing PETITION OF RESPONDENT FOR REHEARING, is presented to the court in good faith and not for the purpose of delay.

Dated this 18th day of April, 1968.

WILLIAM P. SIMMONS, JR.
of SHUTTS & BOWEN
1000 First National Bank Bldg.
Miami, Florida, 33131

SUPREME COURT OF THE UNITED STATES

No. 38.—October Term, 1967.

Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc., Petitioner, *v.* C. Gordon Anderson, Trustee. } On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

[March 25, 1968.]

Mr. Justice White delivered the opinion of the Court.

This case involves a corporate reorganization under Chapter X of the Bankruptcy Act, 52 Stat. 883–905, 11 U. S. C. §§501–676. In the most recent proceedings [1] the District Court approved an amended plan of reorganization and discharged the petitioner Committee.[2] The Court of Appeals for the Fifth Circuit affirmed, 364 F. 2d 936 (1966). We granted certiorari, 387 U. S. 929 (1967), because this case presents important questions under the bankruptcy laws. Since we believe the Court of Appeals erred in affirming the decision of the District Court, we reverse the judgment and remand for further proceedings consistent with the views expressed below.

[1] This case has been in the federal courts for over 10 years. The earlier reported decisions consist of the following: *Caplan* v. *Anderson*, 256 F. 2d 416 (C. A. 5th Cir. 1958); *Caplan* v. *Anderson*, 259 F. 2d 283 (C. A. 5th Cir. 1958); *TMT Trailer Ferry, Inc.* v. *Anderson*, 292 F. 2d 455 (C. A. 5th Cir. 1961), cert. denied *sub nom. Shaffer* v. *Anderson*, 368 U. S. 956 (1962); *United States* v. *Anderson*, 334 F. 2d 111 (C. A. 5th Cir.), cert. denied, 379 U. S. 879 (1964); *In re TMT Trailer Ferry, Inc.*, 334 F. 2d 118 (C. A. 5th Cir. 1964).

[2] The order of the District Court discharging the petitioner Committee was later modified to permit the Committee to prosecute appeals from that decision.

I.

The debtor, TMT Trailer Ferry, Inc., was incorporated in 1954. Its principal business is transporting freight between Florida and Puerto Rico. It pioneered "fishy-back" transport, the ocean-going equivalent of "piggy-back" transport. Freight loaded into highway trailers is rolled on and off sea-going barges without rehandling. In its original operations TMT used rented tugs to tow converted Navy LST's loaded with such trailers and other freight. Later it undertook to convert a self-propelled Navy LSD for use in its business. Substantial debts and losses arose from the unsuccessful conversion and consequent failure in service of this ship, dubbed the "Carib Queen."

In addition, between 1954 and 1957, more than 4,000,000 shares of TMT common stock were issued, many of them acquired at low prices by persons close to the company and disposed of to the public at relatively high prices. As a result of these transactions and others, TMT became unable to meet its obligations, and a reorganization proceeding was initiated against it by involuntary petition in June 1957. The debtor consented to reorganization, and C. Gordon Anderson was appointed trustee. The motion of the holders of preferred ship mortgages on the debtor's vessels (the Caplan mortgage) to foreclose their liens was denied by the trial court. On appeal from this order, it was pointed out that no plan of reorganization had yet been proposed, that the possibility of successful reorganization had not been explored, and that no evidence had been received to support any of the court's orders. The Court of Appeals reversed and remanded with instructions that the holders of the Caplan mortgage be permitted to foreclose unless adequate provision was made to protect their interests or unless they would not be prejudiced by further delay.

Upon remand the trial court held appropriate hearings. It was determined that the debtor was being operated in a manner which would produce substantial profits. A plan of reorganization was proposed which would have given the Caplan mortgage group all the common stock in the reorganized company, a substantial portion of the preferred stock, and control of the board of directors. In February 1959, without a hearing called for that purpose and solely on the basis of documents and records, the trial court declared the debtor insolvent and held that the original stockholders had no further interest in the reorganized corporation. In March 1959 the plan of reorganization was confirmed, and Anderson resigned as trustee to become president of the reorganized company. A new trustee was appointed, and he sought in effect to vacate the order confirming the plan. His petition alleged that the holders of the Caplan mortgage and Merril-Stevens Dry Dock & Repair Co. (M–S), another substantial creditor, had entered into an undisclosed agreement in violation of § 221 of Chapter X, 52 Stat. 897, 11 U. S. C. § 621, an agreement according to which the Caplan mortgage group would pay M–S in order to procure its consent to the plan of reorganization. This petition was denied, the successor trustee was removed, and Anderson was reinstated as trustee.

The petitioner Committee appealed from the order confirming the reorganization plan. Objection was made to the failure of the trial court to order an investigation into the claims of certain creditors and to the failure to conduct a hearing on insolvency. While that appeal was pending, the Caplan group, supported by Anderson, petitioned the trial court to consummate the confirmed plan. The Securities and Exchange Commission, however, filed a petition in the trial court seeking an investigation.[3] It

[3] The SEC participated as a party in both the District Court and the Court of Appeals, and has appeared as an unnamed respond-

alleged that an investigation would disclose that the plan was unfair because it turned the corporation over to persons who had dealt extensively in the stock of the debtor in transactions which were probably illegal. It was agreed among the parties that an investigation should be made.

Anderson, in his re-established role as trustee, conducted the investigation. Fourteen days of hearings were held, 2,200 pages of testimony transcribed, and some 60 exhibits collected. Anderson's report from this investigation covers 40 pages in the original record. He concluded that the debtor's business had been "wrecked by gross mismanagement, by unwise and unsound expansion financed primarily through the sale of securities in disregard of the protective provisions of the Securities Act of 1933," and that the debtor had substantial causes of action against holders of the Caplan mortgage. Upon the recommendation of Anderson, the trial court vacated its order confirming the 1959 plan, and the Court of Appeals affirmed.[4]

Early in 1962 two new plans of reorganization were proposed. The "internal plan," recommended by Anderson, provided for reorganizing the debtor by issuing new common stock to creditors and involved "compromises" of the Caplan mortgage and M–S claims. The "cash plan" entailed similar "compromises" as well as selling the debtor's assets for cash to persons unconnected with the company and distributing the cash

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ent before this Court. See 52 Stat. 890, 894, 11 U. S. C. §§ 572, 608. This Court requested the SEC to express its views at the petition stage, 386 U. S. 901 (1967). For the most part the SEC has taken positions consistent with those of the petitioner Committee.

[4] *TMT Trailer Ferry, Inc.* v. *Anderson*, 292 F. 2d 455 (C. A. 5th Cir. 1961), cert. denied, 368 U. S. 956 (1962). The Committee's earlier appeal attacking the confirmation of the 1959 plan, which had been consolidated with this appeal by the Caplan mortgage group, was mooted by the order of the trial court vacating the confirmation.

to creditors. Neither plan provided for any participation by stockholders. The Committee, supported by the SEC, objected to the exclusion of stockholders from both plans, and opposed the internal plan because it contemplated that Anderson would become president of the reorganized company. After hearings on valuation, the District Court found the debtor insolvent and approved both plans as fair, equitable, and feasible. A majority of all classes of creditors other than the United States accepted the internal plan, and the District Court confirmed it in February 1963. The Committee appealed, supported by the SEC, arguing that the plan wrongly excluded stockholders and improperly contemplated that Anderson would become president. The Court of Appeals ruled, without reaching the other contentions, that it was permissible for the plan to contemplate Anderson becoming president,[5] but it held in a separate appeal that the plan was defective for not giving priority to the Government's nontax claims.[6] The case was accordingly remanded to the District Court for determination of whether the plan would be feasible if the Government's claims were given full priority.

On remand further hearings were held, the District Court found that if the Government's nontax claims were given priority the plan would be feasible, and amendments were authorized which provided for immediate cash payment to the Government. The Court regarded the failure of the Court of Appeals to reverse its other orders as in effect an affirmance of them, and it refused to consider again the contentions of the Committee and the SEC. The creditors accepted the amended plan and, over the objections of the Committee and the SEC that the plan was not fair or equitable, the District

[5] *In re TMT Trailer Ferry, Inc.*, 334 F. 2d 118 (C. A. 5th Cir. 1964).

[6] *United States* v. *Anderson*, 334 F. 2d 111 (C. A. 5th Cir.), cert. denied, 379 U. S. 879 (1964).

Court affirmed it. The Committee again appealed, and the Court of Appeals ruled that its earlier decision had left open all issues not in terms discussed and decided.[7] Passing over the fact that the District Court had considered the case in erroneous legal perspective, and emphasizing that its obligation was to determine whether the trial judge had "abused his discretion" or reached conclusions which were "clearly erroneous," the Court of Appeals refused to remand the case. Stating that "[t]his . . . litigation must at long last be brought to an end," the Court of Appeals affirmed all judgments and orders of the District Court. The Committee, again supported by the SEC, has presented a number of questions on certiorari to this Court.[8] Because of the view we take of this case, it is necessary to consider only the questions of whether it was error to affirm the District Court's approval of compromises of substantial claims against the debtor, and whether it was error to affirm the District Court's judgment that the debtor was insolvent, when that judgment was rendered without considering the future estimated earnings of the reorganized company.

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[7] *Protective Committee, etc.* v. *Anderson*, 364 F. 2d 936, 939 (C. A. 5th Cir. 1966).

[8] The other issues, briefed and argued at length, are succinctly stated in the brief filed by the SEC:

"1. Whether under Chapter X of the Bankruptcy Act, which provides for a disinterested trustee as the focal point of the reorganization, the trustee is precluded from assuming the presidency of the reorganized company; and whether a plan that contemplates that result may be confirmed.

"4. Whether the courts below erred in refusing to consider the merits of the stockholders' claims based on asserted violations of the securities laws.

"5. Whether the district court erred in discharging the Stockholders' Committee before the reorganization proceedings were completed, on the basis of its finding that the debtor was insolvent." Brief for SEC, at 2, 3.

II.

Compromises are "a normal part of the process of reorganization." *Case* v. *Los Angeles Lumber Prods. Co., Ltd.*, 308 U. S. 106, 130 (1939). In administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts. At the same time, however, it is essential that every important determination in reorganization proceedings receive the "informed, independent judgment" of the bankruptcy court. *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436 (1933). The requirements of §§ 174 and 221 (2) of Chapter X, 52 Stat. 891, 897, 11 U. S. C. §§ 574, 621 (2), that plans of reorganization be both "fair and equitable," apply to compromises just as to other aspects of reorganizations. *Ashbach* v. *Kirtley*, 289 F. 2d 159 (C. A. 8th Cir. 1961); *Conway* v. *Silesian-American Corp.*, 186 F. 2d 201 (C. A. 2d Cir. 1950). The fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable. *In re Chicago Rapid Transit Co.*, 196 F. 2d 484 (C. A. 7th Cir. 1952). There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every

instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation. It is here that we must start in the present case.

The Caplan mortgage, consisting of preferred ship mortgages on the debtor's vessels, bears a face amount of $330,000. The holders paid $280,500 for it. Under the proposed compromise, the holders would receive $280,500 paid in five annual cash installments, plus interest from the original due date.[9] The claims filed against the debtor's estate by M–S totaled $1,628,284, of which $574,580 were said to be secured by maritime liens on the debtor's vessels. Under the terms of the compromise, these claims are to be allowed in full, after reducing them all to the status of unsecured claims. As with other unsecured claims, they would be paid for by issuing common stock in the reorganized company. M–S would wind up holding approximately 40% of the stock in the new company.[10] A glance at these terms makes it clear that the compromises involve substantial recognition of the claims filed by the Caplan group and M–S against the debtor. Whether compromising on these terms was fair and equitable to the debtor, the other creditors, and the stockholders depends upon the proper assessment of the claims which the debtor allegedly had against both the Caplan group and M–S.

The Caplan mortgage was the focal point of the 1960 investigation conducted by the trustee, Anderson. The

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[9] The interest is to be treated as an unsecured claim payable in common stock in the reorganized company. The plan confirmed by the court was later amended to provide that the holders of the Caplan mortgage would receive $250,000 in cash at the date of consummation of the reorganization plan, rather than $280,500 over five years.

[10] Since the rest of the voting stock will go to the other numerous and scattered general creditors, petitioner argues that M–S's 40% ownership will give it initial working control of the reorganized company. Petitioner's Brief, at 28, 29.

mortgage was entered into shortly before the petition in bankruptcy was filed. It was needed to raise cash to meet payments due on the *Carib Queen*. After an extensive investigation, Anderson concluded that the mortgage was a fraudulent transfer not given for fair consideration. Anderson's report succinctly stated the unfairness of the terms of the mortgage:

> "The Caplan Group paid $280,500 cash for the mortgage to TMT which paid all the expenses of the transaction. The mortgage was for $330,000 payable in seven months and is convertible into common stock at the option of the holders, one share of common for each $1.25 of principal amount of the mortgage. This gave the Caplan Group an effective interest rate of 30% per annum prior to maturity and an opportunity to straddle because of the conversion feature. If TMT prospered, they could convert the mortgage into common stock for which they would have paid little more than $1.00 per share; if TMT did not, the Caplan Mortgage was in a senior position and constituted a lien on TMT's prime assets, absolutely necessary to the Company's operation. Since the Carib Queen had broken down, the vessels encumbered by the mortgage were the main producers of income for the company."

Anderson found that there was "ample evidence" to support this view of the mortgage, and that therefore the mortgage should be treated as null and void. So treating it would not release TMT from the obligation to repay the money received, but in claiming that amount the holders of the mortgage would have no higher status than general unsecured creditors.[11]

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[11] Accordingly, to pay holders of the Caplan mortgage $280,500 in cash, even though only the amount they paid for the mortgage,

In addition, Anderson's report concluded that the principal holders of the Caplan mortgage, Abrams, Shaffer, and Erdman had diverted corporate opportunities through the flagrant abuse of their control, fiduciary or inside positions, and should be made to account for the profits they had made. Nearly half of the roughly 4,000,000 shares of outstanding TMT common stock reached the public via purported private offerings through Abrams and Shaffer. These two men exercised a high degree of control over the affairs of the company, and Erdman went along with them and participated in many of their transactions. Anderson found that these three occupied a fiduciary relationship with TMT, at least insofar as issuance of capital stock to them was concerned. "They took advantage of their inside position to obtain stock for less than the market price which they sold to the public without any registration under the Securities Act and in apparent violation of the private offering exemption under which all the stock was issued." The activities of these three men substantially lessened TMT's chances of obtaining financing from reputable financial institutions "and by the time the Caplan mortgage was executed they were in a position to dictate terms which TMT would be forced to accept." Anderson's report continued:

> "It is the opinion of the trustee that persons such as Abrams, Shaffer and Erdman who come in as creditors of TMT under the Caplan Mortgage . . . should be barred in this equity proceeding from profiting at TMT's expense. Their claims should be reduced by the profits they have made on sales of TMT stock which they acquired for private in-

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would be a substantial preferment of them when the reorganization plan allows general unsecured creditors only a pro rata portion of some 1,300,000 shares of new common stock in the reorganized company.

> vestment purposes, but which they sold in violation of the law at great profit to themselves. These profits are either admitted or readily ascertainable and should be returned to the company."

Characterizing the conduct of Abrams, Shaffer, and Erdman in acquiring unregistered TMT stock with no intention of holding it for investment as a "fraud," Anderson indicated the possibility of liability under the SEC's Rule 10b–5.[12] Anderson said that at a minimum their claims should be subordinated to those of innocent creditors.[13]

As a result of the report filed by trustee Anderson, the order confirming the 1959 plan of reorganization was vacated. Both the trustee and the SEC filed objections to the Caplan mortgage claim, grounded on the reasons presented in the report of the investigation. The District Court never held hearings on these objections. The mortgage was not set aside as a fraudulent transfer, nor was it decided to use the claims against Abrams, Shaffer, and Erdman as set-offs or as a means of subordinating the mortgage claims. Rather, the internal plan of reorganization was approved by the District Court, providing for a "compromise" of the Caplan mortgage along the lines already indicated. The holders of the mortgage were to receive in cash what they had put up for the mortgage, plus interest on the principal from the original due date.[14]

Separate from the Caplan mortgage claims were the claims filed by M–S, the company in charge of converting the Navy LSD into the self-propelled trailership

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[12] 17 CFR § 240.10b–5; promulgated by the SEC pursuant to § 10 (b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U. S. C. § 78j.

[13] Such subordination would effectively eliminate their claims if TMT were as insolvent as the court subsequently found.

[14] These terms were later modified, as indicated in n. 8, *supra*.

which TMT christened the "Carib Queen." These claims totaled $1,628,284, of which over $1,000,000 was for the unpaid balance due for converting the *Carib Queen*. Maritime liens on other vessels owned by TMT allegedly secured $574,580 worth of these claims. The United States, in its position as a substantial creditor of TMT, filed objections to M–S claims, stating that none of them were entitled to status as secured claims "for the reason that they arose more than one year prior to the commencement of the reorganization proceedings herein." It also contended that the claims had no status as secured lien claims, for "it is a recognized principle of Admiralty and Maritime law that claims for the construction or reconstruction of vessels do not give rise to Maritime liens." Whether the portion of the claims for which M–S asserts secured status are actually entitled to that status has never been determined. The "compromise" of the M–S claims amounted to allowing them in their full amount as unsecured claims.

On the maiden voyage of the *Carib Queen* a series of boiler failures caused the vessel to break down and necessitated extensive repairs. In November 1958 the petitioner Committee notified the District Court that in its opinion the "series of catastrophes" which had befallen the *Carib Queen* was due to "faulty design, inadequate inspection, defective work on the remodeling and later repair of the ship, hasty and improper preparations for a hazardous sea voyage and utilization of the ship in a service for which she was not fitted and in an unseaworthy condition." The Committee thought that TMT had causes of action which could lead to the recovery of substantial sums of money. Although Anderson's report on his subsequent investigation of the affairs of TMT dealt with causes of action other than those associated

with the Caplan mortgage, it made no mention of any claims TMT might have against M–S. The SEC objected to the M–S claims, stating that there were grounds for disallowing them and that the matter should be referred to a special master for investigation. Trustee Anderson also sought reference of these claims to a special master. On September 1, 1961, the SEC filed detailed specifications of its objections to the M–S claims, based on its own investigation into them. The SEC stated that the debtor

> "has meritorious defenses and an offset or counterclaim because M–S (a) did not properly convert the vessel; (b) did not comply with the terms of the contract; (c) did not properly repair the vessel; and (d) performed certain work for and furnished certain materials to TMT, with no agreement as to price; M–S has failed to establish the value of such work and materials."

The SEC described with some particularity the facts which had led it to this conclusion. The most important of these related to the boiler failure which occurred shortly after M–S delivered the *Carib Queen* for its maiden voyage. Within 48 hours of sailing from Jacksonville, Florida, bound for San Juan, Puerto Rico, it was discovered that a boiler and several tubes were leaking. Tubes overheated, ruptured, and were distorted as a result of scale which had formed on their inner surfaces. The SEC attributed the scale to M–S's negligence in running the boilers with raw water. The SEC also stated that the improper priming of the boilers that occurred on the first trip was due to installation of incorrect baffles by M–S. M–S had undertaken to make the required repairs, and the SEC stated that this repair work was performed negligently, leading to further tube fail-

ures. Part of the M–S claims were for unpaid charges for this repair work. M–S filed an answer on September 1 which admitted that when the *Carib Queen* was delivered it was suffering from "certain construction deficiencies," but denied any liability. It contended that its asserted lien claims were secured and that it had performed the repair work in a proper manner.

Although the SEC and the trustee had sought reference of the M–S claims to a special master for a hearing, no such hearing was ever held. Instead, the trustee subsequently moved for the summary allowance of the claims on the ground that there was only a "remote" possibility of materially reducing them by litigating the objections filed against them, and that such litigation would cause "unnecessary delay."[15] At the hearing during which the trustee presented his motion for allowing the M–S claims in full, no further explanation of this recommendation was provided. Counsel for the Committee protested that "this is not a report, this is a bare statement of conclusion." The trial judge himself recognized the importance of the question. He said:

> "I am concerned myself. I do know that whoever turned that vessel [the *Carib Queen*] loose with the

[15] The trustee reached this conclusion after an investigation described by him in full as follows: "[T]he trustee, with the assistance of attorneys in the office of his counsel, investigated the facts alleged in the specifications of objections filed by the SEC and in the answer by Merrill-Stevens. This investigation consisted of an examination of numerous documents assembled by the SEC during its investigation, together with copies of statements made by individuals which had been obtained during the investigation. Also examined were numerous documents and statements furnished by Merrill-Stevens in support of its answer to the specifications of objections by the SEC." The trustee did not set out any findings of fact which he arrived at in the course of this "investigation," and provided no explanation of the reasoning which had led to his "considered opinion" that the M–S claims should be allowed in full.

> boilers in it, somebody made a bad mistake. I don't know who it was."

The matter was put over, and subsequently the Committee, supported by the Commission, the Department of Justice, and the Caplan mortgage group, filed objections. Notwithstanding these objections, and the doubts that he had earlier expressed, the trial judge confirmed the claims in full as unsecured claims without further investigation of them. M–S, under the confirmed plan, is to receive 40% of the common stock of the reorganized company.

On July 11, 1962, the trial court filed its opinion and order approving both the internal and the cash plans of reorganization. The internal plan contained the provisions for "compromising" the Caplan mortgage and M–S claims. With regard to these sets of claims, the trial court stated that "it was apparent" that successful litigation of the claims TMT had against the holders of these claims "would take possibly years to conclude. . . ." The court continued:

> "It is the opinion of the court that these compromises are fair and equitable under the circumstances and they are hereby approved for inclusion in the Internal Plan. The court approves the opinion expressed by the attorney for the trustee that no better compromises can be obtained for the debtor, that the prospect of material reduction in the amount of these claims does not warrant the extensive litigation that would otherwise be required, and that the prospect of recoveries beyond the amount of the claims as urged by the Securities and Exchange Commission and the Stockholders' Committee is too remote for serious consideration. . . . The alternative to approval of these compromises is extensive litigation at heavy expense to the debtor and un-

> necessary delay in reorganization contrary to the intent and purpose of Chapter X of the Bankruptcy Act."

This statement constitutes the only, and the last,[16] word that the trial court said on the merits of the compromise of the Caplan mortgage and M–S claims. Without reference to any of the objections that had been filed or to the substantial facts in the record tending to cast doubt upon the Caplan mortgage and M–S claims, the court accepted the bald conclusions of the trustee. This despite the fact that the trustee had once concluded that the Caplan mortgage was null and void and that TMT had sizeable set-offs against its holders. This despite the fact that the trustee had once sought reference of the M–S claims to a special master for investigation. This despite the fact that the trustee had never placed on the record any of the facts of his subsequent investigation

[16] In December of 1964, after the case had been remanded for the second time by the Court of Appeals, the Committee sought an order for production of documents relating to the *Carib Queen*, alleging they would show that TMT had a cause of action against M–S and the Caplan group. The Committee said these parties had acted "in collusion with members of the debtor's old management and control group to defraud the Maritime Administration and the debtor by misrepresentation of the reconversion contract price and by premature release of the vessel without proper compliance with the requirements of the reconversion contract. The same documents also bear on the propriety of the compromises . . . ." At the hearing held on this motion it appeared that these documents were held by the Maritime Administration, which had no objection to turning them over but wished the court to issue a formal order so that all parties could have access to them. The court denied the motion, saying "there is nothing in the motion that shows that these documents are material to any issue before this Court."

When reconfirming the plan after the second remand, the court added nothing to the explanation quoted in the text, for it erroneously concluded that approval of the settlement had already been affirmed by the Court of Appeals.

and had never provided any explanation of why he had completely reversed his field on these claims. Although at this point in the proceedings it was clear that Anderson was to become president of the reorganized company, and though the trial court was understandably eager to wind up these protracted proceedings, there nowhere appears an adequate explanation for the trustee's cursory, conclusory recommendation of these "compromises," or the perfunctory, almost off-hand, manner in which the court accepted that recommendation.

If the quoted statement of the trial court had been the result of an adequate and intelligent consideration of the merits of the claims, the difficulties of pursuing them, the potential harm to the debtor's estate caused by delay, and the fairness of the terms of settlement, then it would without question have been justifiable to approve the proposed compromises. It is essential, however, that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law. Here there is no explanation of how the strengths and weaknesses of the debtor's causes of action were evaluated or upon what grounds it was concluded that a settlement which allowed the creditor's claims in major part was "fair and equitable." Although we are told that the alternative to settlement was "extensive litigation at heavy expense" and "unnecessary delay," there is no evidence that this conclusion was based upon an educated estimate of the complexity, expense, and likely duration of the litigation. Litigation and delay are always the alternative to settlement, and whether that alternative is worth pursuing necessarily depends upon a reasoned judgment as to the probable outcome of litigation. The complaint voiced by

counsel for the petitioner Committee to the trustee's report on the compromises, that "this is a bare statement of conclusion," seems equally applicable to the trial court's statement approving those compromises. In these circumstances it was error to affirm that aspect of the District Court's judgment approving inclusion of the proposed compromises in the internal plan of reorganization.

The Court of Appeals dealt with the District Court's approval of the compromises in five sentences. Noting that it was only the Committee and the SEC that were complaining, and remarking that it was unlikely that disallowance of the compromises would result in solvency, it felt that it was "significant that not a single creditor has ever complained of either compromise." 364 F. 2d 936, 941. The question of insolvency will be returned to shortly. The argument that the compromises were properly approved because no creditors objected to them seems doubly dubious. When a bankruptcy court either fails adequately to investigate potential legal claims held by the debtor, or refuses to provide an adequate explanation of the basis for approving compromises, it is scarcely surprising that creditors fail to come forward with objections to the compromises. Moreover, this Court has held that a plan of reorganization which is unfair to some persons may not be approved by the court even though the vast majority of creditors have approved it.[17]

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[17] *Case* v. *Los Angeles Lumber Prods. Co., Ltd.*, 308 U. S. 106 (1939). "[W]here a plan is not fair and equitable as a matter of law it cannot be approved by the court . . . . Congress has required both that the required percentages of each class of security holders approve the plan and that the plan be found to be 'fair and equitable.' The former is not a substitute for the latter." *Id.*, at 114.

The principal argument of the respondent supporting affirmance of the order approving the compromises is that "the district court had before it a thorough record concerning the facts and issues with respect to the compromises of these two claims." Respondent's Brief, at 38. With regard to the Caplan mortgage claim, respondent points out that the facts and circumstances surrounding it were thoroughly documented in Anderson's report of his investigation. It is difficult to see how this strengthens respondent's position, however, for the report carefully documented the conclusion that the Caplan mortgage was a fraudulent transfer and that claims against the individual holders of the mortgage could be used as setoffs. The District Court's approval of the proposed compromise in the face of the facts and conclusions contained in the trustee's report is more difficult to understand than would be approval entered on a blank slate. Respondent also points out that the trial court had before it an answer to Anderson's report, the various objections filed to the mortgage claim, the claim itself, and the recommendations of the Creditors Committee, the trustee and the trustee's counsel favoring the proposed settlement. The objections filed to the claim militate against the advisability of compromise, however, and the other matters referred to consist either of conclusory denials of liability or conclusory statements that the claims should be compromised. There is nothing in all these documents which could provide a sound basis for concluding that the claims against the mortgage and its holders were unmeritorious.[18] If the

[18] The answer filed to the Anderson report occupies seven pages in the record. Aside from bare statements that insufficient facts were found and that the trustee's conclusions were not conceded, it opposes vacating the original plan of reorganization almost wholly on grounds of estoppel, laches, *res judicata*, and reliance. The

trial court ever had before it facts which showed the claims against the Caplan mortgage and its holders to be without merit, or if the court ever discovered sound grounds for thinking that the delay incident upon litigation or the unlikelihood of obtaining an adequate recovery, made compromise advisable, nothing in this record indicates it.

With regard to the M–S claims, respondent contends that the record contains "an abundance of pleadings and allegations" respecting them. Respondent's Brief, at 33. To make an informed and independent judgment, however, the court needs facts, not allegations. Respondent also contends that there were sufficient facts in the record, and provides a long list of references to the places in the record where these facts can be found. If, indeed, the record contained adequate facts to support the decision of the trial court to approve the proposed compromises, a reviewing court would be properly reluctant to attack that action solely because the court failed adequately to set forth its reasons or the evidence on which they were based. The deficiency in this case, however, is not a merely formal one. The evidence referred to by respondent is analyzed at greater length in the margin.[19]

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claim itself merely details the terms of the mortgage and the amounts due under it. The recommendations favoring settlement stated only that the merits of the claims had been examined, that the possibility of recovery was remote, and that litigation would cause "unnecessary delay."

[19] Respondent contends that the trial court could have rendered an informed decision on the merits of the M–S compromise on the basis of the following matters in the record:

(1) *The summary of M–S's proof of claim* (the full proof not having been included in the record). This merely stated the amounts claimed by M–S and the liens asserted to secure some of the claims.

(2) *The 1958 letter from the Committee to the Court.* This asserted that TMT had good causes of action against M–S which would result in substantial recovery. With regard to the *Carib Queen*, it accused M–S of "faulty design, inadequate inspection,

Here it is enough to say that to the extent that the record contains solid facts of the sort necessary for appraising the merits of the claims against M–S, virtually all of them point to the probable existence of valid

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defective work on the remodeling and later repair of ship, hasty and improper preparations for a hazardous sea voyage and utilization of the ship in a service for which she was not fitted and in an unseaworthy condition."

(3) *The trustee's report.* This merely stated a few facts relating to the breakdown of the *Carib Queen* on her maiden voyage, and the expenses incurred in connection with the *Carib Queen.*

(4) *The SEC's specifications in support of the objections to the M–S claims.* This was a report of the SEC's independent investigation of the M–S claims. It set out in some detail the facts supporting its contention that TMT had good defenses or set-offs because "M–S (a) did not properly convert the vessel; (b) did not comply with the terms of the contract; (c) did not properly repair the vessel; and (d) performed certain work for and furnished certain materials to TMT, with no agreement as to price; M–S has failed to establish the value of such work and materials."

(5) *The M–S answer to these specifications.* This was principally a formal document and contained no additional facts or arguments. It admitted that the *Carib Queen* was suffering construction deficiencies when delivered to TMT and that there was a boiler failure on the first voyage, but denied liability.

(6) *The motion for allowance of the claim filed on behalf of the trustee.* This summarized the proceedings relating to the M–S claims. Noting that the SEC had filed detailed specifications of its objections, and that the special master appointed by the court had held no hearings, it stated that the trustee and his attorneys had examined the documents relating to the M–S claims. The motion stated that the trustee had tried unsuccessfully to get M–S to reduce its claims, that the possibility of recovering through litigation was remote, and that litigation would cause unnecessary delay. These conclusions were neither expanded upon nor explained.

(7) *Objections of the United States to the above motion.* The United States opposed the M–S claims on the grounds that none of them were entitled to secured status. They had arisen more than a year prior to the bankruptcy proceedings, and claims for reconstructing vessels do not give rise to maritime liens.

(8) *The transcript of the hearings held on the motion for allowance of the claims.* The transcript of this portion of the hearing

and valuable causes of action. Balancing these facts are nothing but bald assertions to the contrary and general conclusions for which foundations nowhere appear. Particularly noteworthy is the fact that, despite frequent

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occupies five pages. Most of it was devoted to the question of how much time the Committee would be allowed for filing a memorandum objecting to the proposed compromise. The court was told that the trustee and his lawyers had looked at the relevant papers, that the possibility of recovery was remote, and that litigation would cause unnecessary delay. No facts or arguments to support these conclusions were presented. Counsel for the Committee objected that this was not a report but a bare statement of conclusion. The court indicated that someone had been at fault over the boiler breakdown.

(9) *The Committee's specification of objections to the M–S claims.* This 35-page report, 22 of the pages of which are devoted to the *Carib Queen* contract, was the result of an independent examination conducted by the Committee into the M–S claims. The Committee charged M–S with faulty design, construction, and repair of the *Carib Queen*. With regard to two other ships on which M–S worked for TMT, the Committee charged M–S with responsibility for the swamping of one on its trial trip, and with failing to get Coast Guard approval of the other. The Committee also claimed that the maritime liens asserted by M–S had been reduced by payments on account, and that the original TMT management, M–S, and Abrams and Shaffer had worked together in a collusive relationship designed to make large profits by selling cheaply purchased stock to the public at inflated values. Some idea of the factual particularity of the Committee's objections is provided by the abbreviated subheadings of their charges against M–S in connection with the *Carib Queen*. The Committee stated that TMT had causes of action growing out of the fact that M–S (a) failed to secure proper certificates of work completion affecting the classification and rating of the vessel, (b) failed to fit riveted crack-arresting seams, (c) failed to produce a vessel of 3,050 shaft-horsepower per shaft, propeller speed of 216 r. p. m., and speed in service of 15½ knots, (d) failed to produce a ship of high enough classification and rating, (e) failed to clean the boilers chemically, (f) wrongly assumed that the boilers had been properly protected up to the time of conversion, (g) failed to use distilled water in

requests for an investigation, and notwithstanding the fact that the available evidence pointed to probably valid claims against M–S, no investigation of these matters was ever undertaken or ordered by the trial court. It is difficult to imagine how an informed and independent decision in favor of compromising the M–S claims in the full amount as unsecured claims could have been reached on the present state of the record.

The record before us leaves us completely uninformed as to whether the trial court ever evaluated the merits of the causes of actions held by the debtor, the prospects and problems of litigating those claims, or the fairness of the terms of compromise. More than this, the record is devoid of facts which would have permitted a rea-

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its preliminary running of the boilers, (h) improperly connected the piping, (i) installed incorrect baffle plates, (j) failed to clean the boilers adequately when performing the repair work, (k) failed to install the ventilating system properly, (*l*) installed an inadequate and inappropriate evaporator, (m) failed to put the feed water regulator and the feed pump governor into proper working order, (n) failed to install a boiler compound injector pump, (*o*) failed to provide equipment for coping with the excessive oxygen content of the water in the system, and (p) was responsible for deficiencies in the electrical system. In addition, the Committee stated that M–S was improperly claiming for repair work done under its guarantee obligation, and that M–S had included claims for work done as to which no amount had ever been agreed upon.

(10) *The statement by the SEC supporting the Committee's specification of objections.* The SEC, while not necessarily agreeing with all the allegations and contentions of the Committee, felt that the Committee had demonstrated that M–S should be required to prove its claims at a judicial hearing.

In addition to these matters of record, respondent refers to several matters not in the record, which are said to support the propriety of accepting the compromises. Matters not in the record and not properly the subject of judicial notice cannot form the basis of judicial confirmation of a plan of reorganization. They are equally unavailing on review.

soned judgment that the claims of actions should be settled in this fashion. In reaching this conclusion, however, it is necessary to emphasize that we intimate no opinion as to the merits of the debtor's causes of action or as to the actual fairness of the proposed compromises. To the contrary, it is clear that the present record is inadequate for assessing either, and that a remand is necessary to permit further hearings to be held. Only after further investigation can it be determined whether, and on what terms, these claims should be compromised.

III.

Under §§ 174, 221 (2), of Chapter X, 52 Stat. 891, 897, 11 U. S. C. §§ 574, 621 (2), a bankruptcy court is not to approve or confirm a plan of reorganization unless it is found to be "fair and equitable." This standard incorporates the absolute priority doctrine under which creditors and stockholders may participate only in accordance with their respective priorities, and " . . . in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts . . . ." *SEC* v. *United States Realty & Improvement Co.*, 310 U. S. 434, 452 (1940). Since participation by junior interests depends upon the claims of senior interests being fully satisfied, whether a plan of reorganization excluding junior interests is fair and equitable depends upon the value of the reorganized company. In the present case the District Court excluded the stockholders from participation because of its finding that the debtor was insolvent. Since the determination of insolvency was not made in accordance with the proper standards of valuation, neither the approval nor the confirmation of the plan can stand.

The appropriate standard for valuing a company undergoing reorganization was set out at length in *Con-*

solidated Rock Products Co. v. *Du Bois,* 312 U. S. 510, 526 (1941):

> "As Mr. Justice Holmes said in *Galveston, H. & S. A. Ry. Co.* v. *Texas,* 210 U. S. 217, 226, 'the commercial value of property consists in the expectation of income from it.' . . . Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. . . . The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable. . . . Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made. But that estimate must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance." [20]

In the present case the book value of the debtor's assets on May 31, 1962, was $1,887,185.77. Claims against the

[20] Further on the subject of valuation, see 2 Bonbright, Valuation of Property 880–881 (1937); 6A Collier, Bankruptcy ¶¶10.13 and 11.05 (14th ed. 1965); Guthmann & Dougall, Corporation Financial Policy 656–657 (4th ed. 1962). See also Frank, Epithetical Jurisprudence and the Work of the SEC in the Administration of Chapter X of the Bankruptcy Act, 18 N. Y. U. L. Q. Rev. 317, 342, n. 68 (1941): "Value is the present worth of *future* anticipated earnings. It is not directly dependent on *past* earnings; these latter are important only as a guide in the production of future earnings."

debtor totaled $5,477,370.05. The actual fair value of the debtor's total assets was $2,238,387.62 and their net value was $1,978,481.73. Although these figures show that liabilities far exceeded assets, they are not of controlling importance. The District Court recognized that going concern value, not book or appraisal value, must govern determination of the fairness of the plans of reorganization, and respondent concedes that the value of TMT's business depended "not on the inherent value of its assets but primarily on maintaining a high level of earnings." Brief for Respondent, at 42.

At the valuation hearings the trustee stated that his analysis of the financial structure and business of the debtor resulted in a going concern value of $2,031,403.72. A valuation expert presented by the trustee estimated the going concern value at between $1,607,692 and $1,800,000. He arrived at his conclusion by multiplying his estimate of the future earnings of the company by 7.7, a figure based on the assumption that earnings would be 13% of value. The valuation expert presented by the Committee concluded that estimated future earnings after taxes would be $327,500, and multiplying this by a price-earnings ratio of 13.8, arrived at the conclusion that TMT had a value of $4,519,500. The trial judge took an intermediate position. By projecting current earnings of the debtor for the first five months of 1962 over the remainder of the year, he concluded that pre-tax earnings would be $568,000. Reduced by estimated income taxes and capitalized at 10%, this yielded a going concern value of $2,780,000. Since this figure fell well below the $5,477,370.05 of outstanding claims, he concluded that the debtor was insolvent. On this basis the plan was approved and confirmed.

When the Court of Appeals remanded to the District Court for determination of the feasibility of the reorganization plan after giving full priority to the Govern-

ment's claims, the District Court concluded that TMT was "more insolvent now than it was in 1962," for earnings had declined from the high point of 1962, and the Court's initial determination had been based on the projected earnings for that year. The decline in earnings had occurred even though the volume of business had grown substantially, for increased competition from large steamship lines serving Puerto Rico had forced TMT to lower its rates and thus its margin of profit. The District Court reaffirmed its finding of insolvency. On appeal, the Court of Appeals stated that it did not have to determine whether or not the District Court's finding of insolvency was accurately computed, but merely whether it was "clearly erroneous." On this basis the conclusion of insolvency was affirmed.

In a complex case of this nature it is not the province of this Court to attempt to retry issues of fact which have been fully litigated below. Indeed, as the Court of Appeals stated, much weight must be given to the long familiarity of the district judge with the debtor and to his evaluation of the witnesses who testified in his presence. In the face of conflicting expert testimony as to the going-concern value of the debtor based on current earnings, the trial judge adopted a position in between. We are not disposed to dispute the conclusion of the Court of Appeals that this determination by the trial judge was not "clearly erroneous." However, examination of the facts of this case demonstrates that the District Court did not have before it all of the evidence and testimony relating to the future problems and prospects of the company which was necessary to assess its value as a going concern. Indeed, the trial judge steadfastly refused to consider the value of the company once it was out of the reorganization proceedings. In this there was error, and it was an error which infected the conclusions of the trial court that the debtor was insol-

vent. Evaluations of evidence reached by the accurate application of erroneous legal standards are erroneous evaluations.

TMT plays a minor but unique role in carrying goods between Puerto Rico and the United States. This domestic offshore trade is highly competitive and generally unprofitable. The high density, high volume, and high operating-cost trade with Puerto Rico flows in and through the North Atlantic Ports. TMT, operating in a triangle between San Juan, Puerto Rico, Miami, and Jacksonville, is confined to the low density, low investment South Atlantic trade. TMT carries only about 2% of the total trade with Puerto Rico, and the dominant carrier in the market is in direct competition with it in its home port of Jacksonville. When TMT entered the market with its novel idea of carrying roll-on and roll-off freight in towed vessels, the market was ripe for an innovation of this sort. However, the ills which plagued its early years threw TMT into bankruptcy in 1957. Prevented by the exigencies of the bankruptcy proceeding from capitalizing on the novel idea it had introduced, TMT has watched the development of container shipping, which has taken over a large share of the United States-Puerto Rico trade for which it might otherwise have hoped to compete. Nonetheless, TMT remains the only roll-off and roll-on carrier in the trade, and it has seen its own business rise 10% to 20% a year due to the increased frequency of direct interchange with piggy-back rail transport. Despite the inability of TMT to capitalize on its novel idea, it has remained in a strong competitive position. Trade with Puerto Rico has increased steadily and rapidly, and TMT's business has grown commensurately. Despite a destructive rate war which markedly lowered the revenues earned per voyage, TMT increased its revenue from $3,801,000 in 1962, when the first insolvency hear-

ing was held, to $4,779,000 in 1964, the latest year in the record. Between the 1962 and the 1965 hearings the fleet of vessels was increased from three to five and the number of truck trailers from 350 to 670. Moreover, in the 1965 hearing the business manager could report that after it paid the forthcoming installment for the reconversion of one of its vessels, the company would have no further significant outstanding indebtedness. TMT has continued to be the only unsubsidized carrier in the South Atlantic trade, the only one that makes money. Despite the increase in volume and revenue, however, the rate war and other factors such as rising costs caused net earnings to drop after 1962, and they have not yet regained the level established that year. TMT's tax-loss carry-over has expired, with the result that earnings are now substantially reduced by federal taxes. The general trade picture between Puerto Rico and the United States is in flux, and the rates applicable to the trade are undergoing continuing revision and investigation. The vessels TMT uses are old and in need of replacement. The supply of LST's has nearly dried up, and it seems to be understood that the replacement vessels will have to be built from scratch.

In short, TMT would seem to be a company which has established, preserved, and increased its share of a highly competitive market despite intense competition and major internal crises. It operates in a market undergoing substantial change and is itself faced with the imminent need to re-equip its fleet. In these circumstances, an adequate notion of the going concern value of TMT could be obtained only by looking to the future as well as the past. Against this background we must examine the information which the trial court had before it for assessing the future prospects of TMT. The basic source for information on these matters was, of course, the trustee and his business manager. A short summary of

the highlights of their testimony as it related to the future prospects of TMT will demonstrate the inadequacy of the information provided the trial judge for making this crucial determination.

At the first insolvency hearing the business manager attempted to estimate the earnings of the company for the next four years, but he made his projections solely on the business as it then was. Although TMT had attained the maximum number of voyages possible with the fleet it then had, the business manager had not looked into the possibility of chartering additional vessels. The trustee testified that several vessels would have to be replaced in the next two years, but admitted that he was unable to predict what such vessels would cost. When the trustee was asked if there was foreseeable room for expansion of TMT's business, the Court agreed with an objection that this was beyond the scope of the valuation hearing. The trustee's expert on valuation gave his opinion as to going concern value solely on the basis of the trustee's projection of earnings, which in turn was based wholly on past earnings. Those earnings figures had been drawn up some time prior to the hearing, and it was conceded that they might have come out differently if the projection had been at the time of the valuation hearing. When asked if he would attempt to predict whether the company would be able to pay dividends once it was out of reorganization, or whether large capital investments would soak up all earnings, the trustee's expert replied that he had not been asked to consider that question and did not think it legitimate. Although he agreed that reasonably foreseeable changes and improvements should be taken into account in valuing the company, he stated that he had been given no information on which to make such predictions.

At the second hearing on the value of the company, the business manager admitted that he had made no new projection of future expenses, revenue, or income, even though three years had passed and the business outlook of the firm was markedly different. Although TMT's fleet had grown in the interim from three to five vessels, and there was an imminent need for replacement of the older ships, the business manager was unable to predict the likely impact on earnings of the acquisition of newer vessels. He stated that the new vessels would be towed craft that loaded from the stern, and that they were apt to cost between $1,250,000 and $1,500,000 each. However, though some studies and inquiries had been conducted, there were no final or definite plans or drawings for the new ships. Although new, better, and more efficient vessels were needed soon to improve the company's competitive situation, in the present state of planning it would be two years after the company was out of reorganization before new vessels would be obtained. At the second hearing, as at the first, the business manager could give no estimate of what portion of the administration costs of running TMT were due to the reorganization proceedings. Although he thought that trade between the United States and Puerto Rico was increasing, he did not know how much or in what ways. Though he thought that TMT's share of the Puerto Rican trade was remaining comparatively constant, he did not know for certain. He also did not know what portion of TMT's present volume of business was attributable to direct piggyback interchange.

The data which the trustee and his business manager had submitted with regard to past income and expenses undoubtedly provided a clear picture of what the company had been experiencing in the past. Given, however, that it was a relatively small and young company

much in need of internal rebuilding and operating in a market undergoing important economic and technological change, it was essential that some clear idea be gained of its future prospects. It seems perfectly obvious that the information introduced at the two hearings was inadequate for gaining even a rough idea of TMT's future prospects.

The fundamental reason that there was insufficient evidence concerning the future prospects of TMT was that the trial court showed itself unalterably hostile to inquiries directed to TMT's future. During the first hearing the following interchange took place when the court cut off a question aimed at determining whether the volume of TMT's southbound traffic could be increased during the off-peak season:

> "Q. But if this enterprise were out from under the proceedings, would it?
>
> "The COURT. Well, we are dealing with an organization that is in. Let's assume that it will stay right there and try to get the value. It is not going to get out until it is reorganized.
>
> Mr. MASON. We are trying to get the value when reorganized.
>
> "The COURT. That is of no importance to me. Let's value it as it now exists to determine what should be done in these proceedings."

At a later time, when counsel again sought to establish that the proper way to value the company was to try to determine foreseeable factors which would affect future earnings, the court pre-empted the answer by remarking, "Mr. Witness, we do not want possibilities." Still later, the judge said:

> "All these projections into the future are not going to bother the Court. These creditors have waited too long to get their money. We have had this

> thing for years and years. I imagine most of them long since have gone to the poorhouse or given up."

One can easily sympathize with the desire of a court to terminate bankruptcy reorganization proceedings, for they are frequently protracted. The need for expedition, however, is not a justification for abandoning proper standards. It is also easy to share the court's concern that creditors receive their money as promptly as possible. However, the right of stockholders to participate at all hung on the result of the valuation proceedings; sedulously eliminating all inquiry into the future may, in this context, have caused the rights of the stockholders to have been relinquished by default.

Although three years elapsed before the next hearing, the judge displayed the same unwillingness to permit inquiry into the future prospects of TMT. When counsel for the SEC tried to open up the subject, the following dialogue occurred:

> "Mr. GONSEN. We have no startling figures, but a series of questions relating to the possible future prospects of this company.
>
> "The COURT. There is no possible future prospects other than what is going on. It is possible it will become the greatest fleet in the world and it is possible to go bankrupt in a few months. As a matter of fact, if the competition had succeeded in their plans, you would have no problem here, they would have been sold.
>
> "Mr. GONSEN. Do I understand Your Honor does not desire me to examine as to evaluation?
>
> "The COURT. You do."

Perhaps the proper reading of the reluctance of the judge to go into future prospects at the second hearing was that in his view the issue of insolvency was no longer in the case. The Court of Appeals had ruled on the ques-

tion of whether the trustee could be the president of the reorganized company and whether the Government's nontax claims should be allowed in full without discussing the other issues. In the trial judge's view, the Court of Appeals' failure to speak on other issues constituted affirmance. On the appeal from the second hearing, however, the Court of Appeals took pains to point out the error in this conclusion. The result of the trial court's ruling was to exclude from the hearing the general issue of insolvency and to limit the hearing to the question of whether developments between the first and second hearings had rendered the plan unfeasible in light of the necessity of giving full priority to the Government's nontax claims. In such circumstances it might be expected that the Court of Appeals would have examined the record to see if the facts supported the conclusion which the trial judge had felt foreclosed from having to make again, but which was in fact still in the case. Instead, however, the Court of Appeals merely quoted at length from the trial court's conclusions that the plan was feasible and stated that the ruling that the company was still insolvent was not clearly erroneous.

At the close of the second hearing the SEC and the Committee argued vigorously that the issue of valuation was still open and that future prospects should have been considered by the judge. Although its view of the effect of the appeal from the first hearing did not require it it do so, the court addressed itself to the merits of this contention in its opinion and order approving the amended plan of reorganization:

> "The SEC and the Stockholders Committee insist, as they did during the valuation hearings in 1962, that the court should have required evidence of future earnings, subsequent to reorganization, based upon estimates of revenues and expenses after substantial changes in operations and acquisition and

> substitution of new type vessels and other equipment, and based upon expanded operations expected to take place under private management. However, neither the trustee or the court can anticipate what the reorganized company will do, and any estimates of future earnings under different circumstances would be speculative and unreliable."

This was not a correct statement or application of the law. This Court has declared that in every case it is incumbent upon the reorganization court to consider "all facts relevant to future earning capacity . . . including . . . all circumstances which indicate whether or not [the past earnings] record is a reliable criterion of future performance." *Consolidated Rock Products Co.* v. *DuBois, supra.* If it is shown that the record of past earnings is not a reliable criterion of future performance, the court must form an estimate of future performance by inquiring into all foreseeable factors which may effect future prospects. In forming this estimate, "mathematical certitude" is neither expected nor required.

In this case we have a company engaged in a hotly competitive market, a market experiencing a severe rate war which would probably alter the relative standings of the competitors. The market as a whole was witnessing substantial technological change, and TMT itself was one of the prime innovators. TMT's principal market, Puerto Rico, was undergoing considerable expansion. It was shown without contradiction that TMT needed to replace its present fleet with new and different ships. It should have been clear to the trial court that the circumstances brought out at the two hearings showed that the past earnings record was not a reliable criterion of future performance, and that sound evaluation of the company as a going concern required examination of the future prospects of the company. The court was

not dealing with an established company in a static market, nor was it being asked to value the company's future prospects by hypothesizing unforeseeable changes in operations or market structure. It was evident that certain specific and predictable alterations would have to be made in the equipment and operations of the company in order to meet foreseeable alterations in the market. The trial court shut its eyes to these important developments and in so doing ignored a cardinal principle of proper evaluation.

IV.

Because only past earnings were relied upon in this case in determining the value of the debtor as a going concern, we reverse and remand to the Court of Appeals with directions to remand to the District Court to hold new hearings on valuation. Without in any way prejudging the issue, it is possible that when the compromises discussed in Part II of this opinion are reconsidered, and when the company is properly valued by taking into account its future prospects, the company will be found not to be insolvent. Such a finding would permit stockholders to participate. There is, therefore, no point in considering at this juncture the question presented by the petitioner concerning the stockholders' claims under the federal securities laws. Since the Committee will, of course, be entitled to participate in the new hearings on valuation and insolvency, the order of the District Court discharging it is vacated. So doing, however, reflects no opinion on the merits of the arguments presented in this Court by petitioner as to why it should not have been discharged. Finally, there is no necessity to determine whether it was improper to contemplate making the trustee president of the reorganized company. A great deal of time has passed since that was deemed an advisable plan, and intervening circumstances may

well have altered the views of the participants. Since new hearings on valuation and insolvency will further protract these proceedings, it seems advisable to put that question aside.

For the reasons stated in this opinion, we reverse and remand to the Court of Appeals for further proceedings consistent with this opinion.

Reversed and remanded.

MR. JUSTICE MARSHALL took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES

No. 38.—October Term, 1967.

Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc., Petitioner, v. C. Gordon Anderson, Trustee.	On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

[March 25, 1968.]

Mr. Justice Harlan, whom Mr. Justice Stewart and Mr. Justice Fortas join, dissenting.

In my opinion, the only question which could be thought even remotely to justify the presence of this case in this Court is whether the trustee, by virtue of his office, was as a matter of law disqualified from being selected as president of the reorganized company. The Court, however, does not decide that question. The review of the massive record in these reorganization proceedings, which have been in the courts for over 10 years and on six occasions before the Court of Appeals at various stages, is not in my view an appropriate task for this Court. Believing that this decision bodes little but further delay in bringing this protracted proceeding to a conclusion, I feel justified in voting to dismiss the writ as improvidently granted, despite the fact that the case was brought here on an unrestricted writ. Since the Court does not reach the "disqualification" issue, I consider it inappropriate for me, as an individual Justice, to express my own views upon it.